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OVERSIGHT ON THE VA HOME LOAN GUARANTY PROGRAM

HEARING

BEFORE THE

COMMITTEE ON VETERANS' AFFAIRS
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OVERSIGHT ON THE VA HOME LOAN GUARANTY PROGRAM

WEDNESDAY, MAY 1, 1985

U.S. SENATE,
COMMITTEE ON VETERANS' AFFAIRS,
Washington, DC.

The committee met, pursuant to notice, at 9:46 a.m., in room SR-418, Russell Senate Office Building, Hon. Frank H. Murkowski (chairman of the committee) presiding.

Present: Chairman Frank H. Murkowski, Senators Arlen Specter, Jeremiah Denton, Alan Cranston, and John D. Rockefeller IV.

OPENING STATEMENT OF HON. FRANK H. MURKOWSKI, CHAIRMAN OF THE SENATE COMMITTEE ON VETERANS' AFFAIRS

Chairman MURKOWSKI. Good morning.

I appreciate seeing so many interested parties represented today.

The Senate Committee on Veterans' Affairs is scheduled to conduct, beginning this morning—and I am inclined to think that, while we will finish our witness list, we will not conclude the hearing today—an oversight hearing on the Veterans' Administration Home Loan Guaranty Program, a subject which has drawn a great deal of interest, both based on facts and opinions.

While everybody is entitled to their own opinions, everybody is probably not entitled to their own facts. I am hopeful that, as a consequence of this hearing, we will be able to reflect on the facts as presented by the witnesses.

I want to extend a welcome to you today. Your input is eagerly anticipated, and we expect that constructive remarks will be entered into the record with the idea of reviewing and reassessing the entire program.

The VA Home Loan Guaranty Program was enacted as part of the Servicemen's Readjustment Act of 1944. The VA Home Loan Guaranty Program has been quite successful, from the standpoint of consumption, on behalf of the veterans and the public and the private sector in general. Obviously, there are more parties participating than just the veteran, but the real estate interests, the banking interests, and others support the program, and appropriately so, because their participation has provided many millions of veterans with an opportunity for homeownership that they might not have otherwise had. It has been a stimulus to the economy of the country.

It is interesting to reflect that, since the inception of the program, the VA has guaranteed over 11.4 million home loans for veterans, at a value of some $234 billion. It is the first time I have heard a figure of significance that approached the current annual deficit—you might say the figure is a little in excess of the annual deficits per year.

To date, the total amount of loans repaid in full exceeds $82 billion. Unfortunately, we saw a rather extraordinary situation, beginning with the recession of the early 1980's and its effect on VA mortgages; the number of defaults and foreclosures has increased sharply. And of course, that situation is not something that is not understood. But the new defaults reported averaged over 13,000 per month in fiscal year 1984. Figures for the first 6 months of fiscal 1985 indicate no decrease.

While we are seeing a move out of the economic decline of the early 1980's, we have seen an increase in defaults.

By comparison, defaults reported averaged about 10,000 a month in 1979. The high number of defaults has led to increased foreclosures. During the past 2 years, foreclosures have averaged about 2,000 per month. This figure is double what it was in 1980, approximately 1,000 per month. Of course, there are more mortgages in existence as well.

The VA practice of acquiring the foreclosed property, in over 90 percent of the cases is the procedure followed. There have been slow sales of acquired properties, I am told, which has resulted in accumulation of a very substantial inventory by the VA.

It is quite alarming to reflect that the VA currently has 21,000 properties on hand, with an additional 11,000 properties pending acquisition.

Of the 21,000 properties in VA possession, nearly 13,000 have been held in excess of 6 months, which is far beyond the normal foreclosure holding period in other home loan programs.

The concurrence of high foreclosure levels, perhaps rather slow property sales for various reasons—perhaps because the properties are overpriced in relationship to the market—and other factors have created negative cash-flows. The consequences of depleting the reserve fund have come before Congress in the past and are presently pending, not only before this committee, but in the House as well, and are of interest to every phase of the industry group, which has seen fit, appropriately so, to express their opinions on whether the fee should be increased from 1 percent—there was a proposal to increase the fee to 5 percent, now the proposal is to increase the fee to 3.8, with the introduction of a 2-percent fee next year.

We will get into that issue further at the hearing.

Until recently, the transfer of funds from the direct loan revolving fund appeared to be sufficient to offset program costs, and the loan guaranty revolving fund operated without the requirement of appropriations. However, after more research by the majority staff, this situation did not appear to be the case.

In reality, the figures indicate that, in 1978, there was a transfer from the direct loan revolving fund to the loan guaranty revolving fund of $100 million. In 1979, $300 million was transferred to the loan guaranty revolving fund for inadequate reserves. In 1980, $200 million was transferred. In 1981, $200 million was transferred; 1982 was a good year, only $50 million was transferred. In 1983, $300 million was transferred. In 1984, $230 million was transferred.

During the period from 1978 to 1984, $1.3 billion was transferred from the direct loan fund to the revolving loan fund, which indicates the inadequacy of the reserve account for that period of time.

Then, we move into 1984 and we find, I assume, in addition, in 1984, a direct appropriation—or a supplemental—of $260 million; 1985, $306 million.

I think it is obvious to everyone that the current methodology in effect over at least the last several years, to 1978, has not been adequate to handle the losses associated with the foreclosure process. As a consequence, there has been about $1.8 billion ultimately infused into the reserve account from either direct appropriations or the Direct Loan Fund.

Current budget estimates of the administration show that an appropriation of $404 million will be needed for fiscal year 1986.

Now, mind you, we are talking about raising this fee from 1 to 2 percent. What is the impact of that increase? I will return to that matter before I conclude my remarks.

To obviate the requirement for appropriations in fiscal year 1986, the administration initially proposed to increase the home loan origination fee from 1 percent to 5 percent for fiscal 1986. The views I expressed then have not changed. I do not think such an increase is the answer to the problem by any means. I am fundamentally opposed to the proposed fee increase from 1 percent to 5 percent for fiscal year 1986, because it ignores the basic problems within the system. Identifying problem areas is what we hope to accomplish at this hearing—and not only the identification of the problems, but recommendations from an industry group regarding how best to address the problems and still provide a workable and acceptable veterans' loan program for the specific purpose of what it was designed to do.

If we intend to restore the VA Home Loan Guaranty Program to financial stability, we must address these underlying causes for the current insolvency.

The proposal contained in the Senate budget resolution by the administration is to phase in a 3.8 percent fee over a 5-year period.

Again, I do not think that this proposal really resolves the problems. Under this proposal, the Administrator would have the authority to reduce the fee below the rate specified in the statute, if such action was warranted by the financial condition of the Loan Guaranty Revolving Fund.

It is evident that we have been kidding ourselves on the program so far by indicating that it really is not as bad as it looks. Evidently nobody had bothered to find out just how deep we had gone into the Direct Loan Fund or the appropriation process to revitalize the reserve accounts.

The task at hand is to identify shortcomings in the operation of the program, as I have indicated, and received your recommendations. It will require the hard work and cooperation of all interested parties; certainly the Veterans' Administration, the veterans' groups, the lenders, the realtors, the home builders, the appraisers, and others will have to get together to get this very worthwhile program back on its feet so it will be able to continue to serve as an important VA benefit and not a drain on other VA programs as they all compete for the ever-shrinking Federal dollar.

I am told that a 2 percent home loan origination fee will generate revenues of about $305 million. But there again, that projection is based on an average historical number of loans made in each year.

While that figure is of some significance, the fact is that the experts have been wrong each year, as indicated by the necessity of generating further funds for the reserve.

We are going to have panel discussions, and I would invite the witnesses for the first panel, Mr. Robert O'Toole, Director of the Loan Guaranty Service, Veterans' Administration, who will be accompanied by Mr. Keith Pedigo, Loan Guaranty Officer from Chicago, IL, Veterans' Administration Regional Office; Mr. F. Michael McReaken, Loan Guaranty Officer, Houston, TX, Veterans' Administration; and Mr. Donald L. Ivers, general counsel.

I welcome you to the witness table and ask that you proceed in any manner in which you wish.

Mr. O'Toole, we welcome you to the witness table, and we note that you represent—not only the Director of the Loan Guaranty Service, but I assume the Irish as well. Well, so do I.

TESTIMONY OF ROBERT M. O'TOOLE, DIRECTOR, LOAN GUARANTY SERVICE, VETERANS' ADMINISTRATION, ACCOMPANIED BY R. KEITH PEDIGO, LOAN GUARANTY OFFICER, VETERANS' ADMINISTRATION REGIONAL OFFICE, CHICAGO, IL; F. MICHAEL McREAKEN, LOAN GUARANTY OFFICER, VETERANS' ADMINISTRATION REGIONAL OFFICE, HOUSTON, TX; AND DONALD L. IVERS, GENERAL COUNSEL, VETERANS' ADMINISTRATION, WASHINGTON, DC

Mr. O'Toole. Well, I appreciate that, Mr. Chairman. And it's a pleasure to appear before you this morning.

You have already identified the other members of the panel, so I won't have to do that.

Mr. Chairman, the VA Home Loan Program, as you have indicated, has assisted over 11.4 million veterans to attain housing; mortgage credit totaling almost $234 billion has been infused into the economy.

Our feeling is that these funds would not have been available without the benefit of this program.

Mr. Chairman, in 1984, over 47 percent of all VA-guaranteed loans were originated on the automatic basis, whereby loan originators, rather than the VA, reviewed the incoming credit of the applicant prior to closing.

The VA continuously reviews its policy regarding underwriting of loans.

At a recent Loan Guaranty Officer Conference here in Washington, underwriting was discussed in detail with respect to the changing economy, different financing plans available, such as buydowns and graduated payment mortgages, and regional concerns with regard to employment and housing needs in different geographical areas.

As a result of this conference, field personnel have been instructed to look at each loan closely to determine such things as past job stability; probability of continued employment, taking into account factory closings, layoffs; and the use of buy-downs and graduated payment mortgages and the applicant's ability to pay.

Recent changes in the Loan Guaranty Program were made by the enactment of Public Law 98-369, the Deficit Reduction Act of 1984. The legislation called for the development of guidelines under which VA will continue to acquire properties securing VA-guaranteed loans which are in default.

Under the new legislation, VA is required to examine the "net value" of the security as a potential asset. The net value is determined by subtracting the estimated costs of acquiring, managing, repairing, and reselling the property from its fair market value.

If the "net value" exceeds the total indebtedness less the maximum amount which VA would have to pay on the security, the VA will acquire the property for resale so as to recover that value and reduce the loss to the Government.

If "net value" does not exceed the difference between total indebtedness and the amount payable under the guarantee, the VA will pay the guarantee claim and allow the holder to dispose of the property.

Field stations are processing foreclosures in conformance with the new formulas, and the legislation has reduced the number of properties conveyed to the VA and the expenses associated with management and resale.

Mr. Chairman, we are continuing to experience a large number of GI loan defaults. During fiscal year 1984, new defaults averaged 13,199 per month, compared with 13,564 in fiscal 1983.

New defaults have averaged 13,540 per month for the first 5 months of fiscal 1985.

Although the holder of a GI loan has the primary responsibility for servicing the delinquent loan, it is the VA's policy that no GI loan should be foreclosed or otherwise terminated unless such action is justified.

In view of the continuing high rate of defaults, we have regularly emphasized to our field stations the importance of personally contacting delinquent veterans in order to assist them to reinstate their loans and retain their homes if it is at all possible.

We have implemented two provisions of the Deficit Reduction Act of 1984, Mr. Chairman, that impact on our Property Management Program: One, the requirement that VA charge a 1-percent funding fee on vendee loans; and second, the requirement that at least 25 percent of our properties be sold for cash during fiscal years 1985, 1986, and 1987.

Our percentage, fiscal year to date, of cash sales is 21.46 percent. We are confident that we will be able to meet and probably exceed the 25 percent cash sale requirement.

During the past 2 years, we have been able to make encouraging progress with our property sales results to reduce our inventory and to minimize the demands on the Loan Guaranty Fund.

In March 1984, we reached our highest number of properties in title, 22,316. But as of the end of March of this year, we had achieved a reduction in that number, to 21,316.

Our fiscal 1984 sales were 18 percent higher than the fiscal 1983 sales and somewhat higher than the combined 1981 and 1982 sales.

During the first half of 1985, we sold 12,775 properties, a figure 37-percent higher than the number sold during the first 6 months of last year.

In March 1985, our field stations sold over 2,500 houses, the highest monthly sales figure since September 1966.

We feel we've been selling properties as quickly and as responsibly as we can.

For example, Mr. Chairman, 70 percent of our present properties have been on hand for less than 1 year.

Chairman MURKOWSKI. Could you give me that figure again?

Mr. O'TOOLE. 70 percent of the current inventory has been on hand for less than 1 year.

Chairman MURKOWSKI. Thank you.

Mr. O'TOOLE. During fiscal years 1983, 1984, and 1985—projected—we sold or will have sold more properties than were on hand at the beginning of each fiscal year.

We presently have 21,300 properties on hand. And we project that we will sell over 26,000 during fiscal 1985.

During the first 6 months of fiscal 1985, we made property sales of $530 million. This compares with $403 million in the first 6 months of last year.

Based on this volume, we expect to sell over $1 billion in houses by the end of fiscal 1985.

Mr. Chairman, to explore additional ways to accelerate the sales of our properties, we have had discussions with the recently formed task force of the National Association of Realtors.

The Realtors Task Force has pledged its cooperation in expediting our property sales. As a first step in this effort, realtors will consider whether VA-owned properties can be entered in its Multiple-Listing Service in order to achieve exposure in more housing markets.

Mr. Chairman, this concludes my statement, and I would be pleased to answer any questions you or members of the committee may have.

Chairman MURKOWSKI. Thank you.

[The prepared statement of Robert M. O'Toole, Director, Loan Guaranty Service, Veterans' Administration, follows:]

PREPARED STATEMENT OF ROBERT M. O'TOOLE, DIRECTOR, LOAN GUARANTY SERVICE, VETERANS' ADMINISTRATION

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you this morning to discuss the operation of the Veterans Administration's housing program. I have with me today R. Keith Pedigo, Loan Guaranty Officer, Chicago Regional Office; F. Michael McReaken, Loan Guaranty Officer, Houston Regional Office; and Donald L. Ivers, General Counsel.

A period of economic stability has permitted VA to keep the interest rate on guaranteed home loans within the 12½ percent to 14 percent range through all of 1984. This is up slightly from the 1983 range of 11½ percent to 13½ percent and down significantly from the 1981-82 levels. The current rate of 12½ percent has been in effect since April 19, 1985. During Calendar Year 1984, VA issued 431,874 certificates of reasonable value and 107,090 certificates of commitment to guarantee loans. Also during that period, the VA guaranteed 209,841 loans, over 65 percent of which were made without a down payment from the veteran purchaser. These no down payment loans had an average purchase price and loan amount of $59,564. For those veterans who obtained loans with a down payment, the purchase price averaged $82,514 with an average loan amount of $72,257. Veterans obtained 11,938 manufactured home loans in 1984. The average purchase price for manufactured homes was $21,753, with an average loan amount of $21,020.

The VA home loan program has assisted over 11.4 million veterans to obtain housing since the program was enacted in 1944. Mortgage credit totaling almost $234 billion has been infused into the economy; much of these funds would not have been available without the benefit of this program. Over $82 billion worth of these loans have been repaid in full as of last year.

There is a continuing emphasis, Mr. Chairman, on improving productivity of field stations. In 1984, over 47 percent of all VA guaranteed loans were originated on the "automatic basis" whereby loan originators, rather than the VA, review the income and credit of the applicant prior to loan closing. We will continue to streamline and improve processing procedures to allow for approval of GI loan applications in a manner which is quick and efficient while still protecting the interests of veterans and the Government.

With regard to protecting the interests of veterans and the Government the VA continuously reviews its policies regarding the underwriting of loans. We have published guidelines on the VA credit standards which are made available to all lenders making VA guaranteed loans. At a recent Loan Guaranty Officer Conference underwriting was discussed in detail with respect to the changing economy, different financing plans available, such as buy-downs and graduated payment mortgages, and regional concerns with regard to employment and housing needs in different geographical areas. As a result, field station personnel have been instructed to look at each loan closely to determine such things as: past job stability and probability of continued employment taking into account factory closings, layoffs, etc; and the use of a buy-down or graduated payment mortgage and the applicant's ability to pay higher monthly mortgage payments over the life of the loan.

VA IMPLEMENTATION OF 1984 LEGISLATION

Recent major changes in the Loan Guaranty Program were made by the enactment of Public Law 98-369, the Deficit Reduction Act of 1984. The legislation called for the development of guidelines under which VA will continue to acquire properties securing VA guaranteed loans which are in default. The standard procedure when VA guaranteed loans went into default had been for the VA to establish a maximum amount that it would pay the holder for the property if the holder was the successful bidder at the foreclosure sale. Establishment of such a price, known as the "specified amount," occurred when it was determined that the value to VA of the real property exceeded the unguaranteed portion of the indebtedness, and VA could reduce its maximum claim liability by acquiring and reselling the security. This procedure also benefitted the veteran, because the value of the property determined the amount specified for credit against the loan indebtedness, and prevented a future deficiency judgment or other indebtedness being established against the veteran based on the prices which prevail at distress foreclosure sales.

Under the new legislation, VA is required to examine the "net value" of the security as a potential asset. The net value is determined by subtracting the estimated costs of acquiring, managing, repairing, and reselling the property from its fair market value. If "net value" exceeds the total indebtedness less the maximum amount which VA would have to pay on the guaranty, the VA will acquire the property for resale so as to recover that value and reduce the loss to the Government.

If "net value" does not exceed the difference between total indebtedness and the amount payable under the guaranty, the VA will pay the guaranty claim and allow the holder to dispose of the property. Field stations are processing foreclosures in conformance with the new formulas and the legislation has reduced the number of properties conveyed to the VA and the expenses associated with management and resale. In FY 1983 specified amounts were established for 96.8 percent of the VA guaranteed loans that were foreclosed. In FY 1984 this figure was 93.6 percent and for the first quarter of FY 1985, this figure is 90.6 percent. The decline is directly attributable to implementation of the property acquisition guidelines called for in Public Law 98-369.

Another significant modification in the Loan Guaranty Program has resulted from the implementation of the newly-enacted section 1830 of title 38, United States Code, which was also part of the Deficit Reduction Act of 1984. The law authorizes VA to bring suit in court to foreclose loans made or acquired by the Administrator. The law provides that this may be done by VA attorneys or on a fee basis.

Section 1830 recognizes that the Attorney General has primary responsibility for supervising all litigation involving the Federal Government and provides that attorneys acting under that section are "subject to the direction and supervision of the Attorney General and to such terms and conditions as the Attorney General may prescribe." The statute further provides that VA may use fee attorneys only "with the concurrence of the Attorney General."

VA may not unilaterally act to implement this new authority. Rather, we must await guidelines to be issued by the Department of Justice. Shortly after the enactment of the Deficit Reduction Act of 1984, the Office of General Counsel of VA met with the staff of the Civil Division of the Department of Justice to discuss the implementation of this new authority. A Memorandum of Understanding, has been signed by the Department of Justice and the VA.

In order to prepare to assume this new responsibility, VA held a training conference December 10-12, 1984. One attorney from each VA field office came to Washington for this session. We had speakers from the Department of Justice, United States Attorneys' Offices, private practice, and the United States Marshal's Office, as well as VA staff.

We believe VA will be ready to begin handling foreclosures shortly.

Other changes brought about by the Deficit Reduction Act that I would like to highlight, Mr. Chairman, are those modifications with respect to the loan funding fee that is collected in connection with VA home and manufactured home loans. The amount of the fee has been raised from one-half of one percent to one percent. The effect of an increase of this size on a veteran's ability to obtain financing has been minimal. The amount of the fee may still be included in the veteran's loan and paid to the

Administrator from the loan proceeds, thus spreading out its payment over the life of the mortgage. With the enactment of Public Law 98-369, the one percent fee is also collected on vendee loans which are purchase money mortgages made by the VA to finance the sale of VA acquired properties. Under the new law, the fees are now deposited directly into the Loan Guaranty Revolving Fund which is used to honor VA's liability under the guaranty agreement and to acquire properties as required by law. Since July 18, 1984, when the law was enacted, $60.1 million has been deposited in the Loan Guaranty Revolving Fund.

Public Law 98-369 also made changes to our Property Management program which I will discuss later in this statement.

A potentially far-reaching change in the Loan Guaranty program was the enactment of Public Law 98-223, the Veteran's Compensation and Program Improvements Amendments of 1984. Certain manufactured home loans that were previously guaranteed under 38 U.S.C. 1819 may now, under the new authority granted to the Administrator by this legislation, be guaranteed under the provisions of 38 U.S.C. 1810. Manufactured home loans now covered under 38 U.S.C. 1810 must be secured by a manufactured home that is permanently situated on land owned by the veteran and that is considered to be real property, instead of personal property, in the State where it is located. Loans guaranteed under 38 U.S.C 1810 may have longer terms and lower interest rates than those guaranteed under 38 U.S.C. 1819.

Public Law 98-223 also expanded section 1802(b)(2) of title 38, United States Code, with respect to the restoration of a veteran's home loan entitlement upon substitution of another veteran's entitlement. The legislation eliminates the requirement that the substituting veteran be the "immediate-transferee" of the property.

Public Law 98-543, the Veterans' Benefits Improvement Act of 1984, increased the maximum amount of specially adapted housing assistance payable under 38 U.S.C. 801(b) from $5,000 to $6,000 for service-connected disabled veterans who are blind or have lost, or lost the use of, both hands. The Specially Adapted Housing Grant payable under 38 U.S.C. 801(a) was increased from $32,500 to $35,500.

LOAN DEFAULTS: SERVICING DELINQUENT LOANS

Mr. Chairman, we are continuing to experience a large number of GI loan defaults. During Fiscal Year 1984, new defaults averaged 13,199 per month, compared with 13,564 in Fiscal Year 1983. New defaults have averaged 13,540 per month for the first five months of Fiscal Year 1985. Defaults reported appear to be remaining stable at relatively high levels.

Although the holder of a GI loan has the primary responsibility for servicing the delinquent loan in default, it is VA policy that no GI loan should be foreclosed or otherwise terminated unless such action is absolutely justified. Consequently, when a new default is reported to VA, our regional offices promptly attempt to contact the borrower by letter, mailgram, telephone, and through field visits to the property. In view of the continuing high rate of defaults, we have regularly emphasized to our field stations the importance of personally contacting delinquent veterans in order to assist them to reinstate their loans and retain their homes if at all possible.

To further aid in our efforts to assist delinquent veterans, we are moving ahead with plans to provide direct on line access to GI loan records. When implemented, up-to-date loan data on individual default cases will be available in seconds via display terminals. The full implementation target date for loan servicing purposes is December 1986. This will enable loan guaranty personnel to service defaults without references to loan folders and respond quickly to inquires from veteran borrowers. Other anticipated benefits include reduction in the flow of papers, and files and improvement in the quality and timeless of data input. Rapid access to the data base will also enable Central Office to closely monitor the operations of our Field Stations.

PROPERTY MANAGEMENT

We have implemented two provisions of the Deficit Reduction Act of 1984 that impact on our property management program: one, the requirement that VA charge a 1 percent funding fee on vendee loans, which I previously discussed; and, secondly the requirement that at least 25 percent of our properties be sold for cash during FY's 85, 86, 87.

During the current fiscal year we have continued to increase the percentage of cash sales. Our percentage fiscal year to date is 21.46 percent. We are confident that, as program participants become more aware of our sales incentives introduced during 1984 for cash sales, we will be able to meet and probably exceed the 25 percent cash sales requirement.

Although we have seen continuing high levels of foreclosures completed during the past 2 years (an average of 2,360 per month during 1983 and 1984), we have been able to make encouraging progress with our property sales results during 1984 and expect to accelerate sales further during 1985 to reduce our inventory and to minimize the demands on the Loan Guaranty Revolving Fund. In March 1984, we reached our highest number of properties in title: 22,316. By the end of the fiscal year, we had reduced that figure to 21,895, and, as of the end of March 1985, we had achieved a reduction to 21,316, with an additional 11,609 properties pending acquisition by VA due to the continuing high foreclosure level.

Our FY 84 sales were 18 percent higher than FY 83 sales, and somewhat greater than FY 81 and FY 82 sales combined. During the first half of FY 85, we have sold 12,775 properties, a figure 37 percent higher than the number sold during the first 6 months of FY 84. In March 1985, our field stations sold 2,562 properties--the highest monthly sales figure since September 1966. Sales for March 1985 represented 12 percent of our total property inventory.

To make our maximum contribution to reduce the need for appropriations, we have been selling properties as quickly and as responsibly as we can. Even though we have an inventory valued at some $800 million because of a steady inflow of new acquisitions, I can assure you that our inventory in general has been turning over, as illustrated by some of the following figures:

- 70 percent of our present properties have been on hand less than one year.

- During FY 83, FY 84 and FY 85 (projected), we sold or will have sold more properties than were on hand at the beginning of each FY. In FY 83 we had 17,164 properties on hand and sold 18,550 and in FY 84 we had 19,872 properties on hand and sold 22,144. We presently have 21,895 properties on hand and we project that 26,200 will be sold during FY 85.

- During the first 6 months of FY 85, we made property sales of $530 million, this compares with $403 million in the first 6 months of FY 84. Based on this volume we expect to sell over a billion dollars in property by the end of FY 85.

The attached chart shows property sales for each month since January 1981 as a percentage of that month's inventory of properties in title.

We have taken several steps to promote sales. Continued emphasis on these program changes should help us to accelerate the downward trend in our inventory during 1985.

- A Property Management Task Force was created to examine the sales efforts of seven of our field stations which had almost 50 percent of our inventory. The Task Force met with both private sector brokers and field station staffs to focus attention on property sales. We have seen a marked improvement in sales at those stations.

- Reasonable offers--below stated list prices--are now invited on all properties on the market for more than 6 months, in order to promote a bargaining type atmosphere on our older inventory properties.

- Sales commission bonuses of up to $500 are offered on older- and lower-priced properties, in order to focus more broker attention on these hard-to-sell properties.

- Discounts of 10 percent off the list price are offered to purchasers who pay all cash.

- We pay reasonable loan discount points where outside financing requires it.

- We held a test auction of 200 hard-to-sell properties in Detroit in October. It was the largest real estate auction in Michigan history. We are going forward to use this technique during 1985 in other locations where we have difficult inventory problems.

To explore additional ways to accelerate the sales of our properties, we have had discussions with the recently-formed Task Force of the National Association of Realtors (NAR). The NAR Task Force has pledged its cooperation in expediting our property sales. As a first step, NAR will consider whether VA-owned properties can be entered in its Multiple Listing Service (MLS) in order to achieve wider marketing exposure.

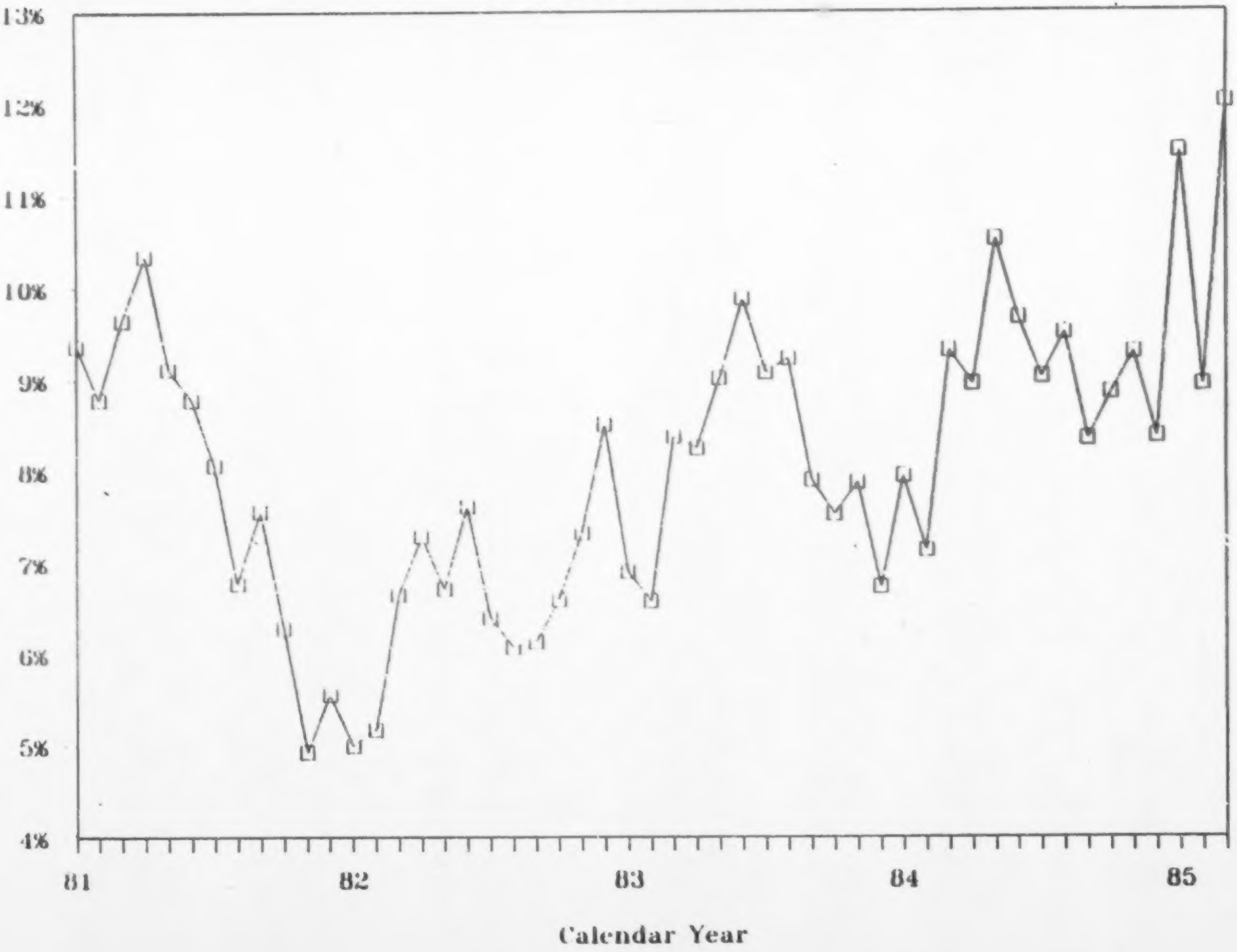
The continuing improvements in our Property Management Sales Activity over the past 5 years are reflected in the following figures:

Fiscal Year	Properties Sold
1980	11,822
1981	10,671
1982	10,857
1983	18,634
1984	22,235
1985(first half)	12,775

Mr. Chairman, this concludes my statement. I will be pleased to respond to any questions that you or Members of the Subcommittee may have.

PM SALES

As Percent of Inventory



Chairman MURKOWSKI. During your presentation, Senator Rockefeller joined us.

And, Senator Rockefeller, we welcome you, in your attendance, to the committee.

The purpose of the hearing, as you know, this morning is to review the VA Home Loan Guaranty Program. The review is based on a positive interest on behalf of the committee to face up to some of the realities associated with the question of the loan origination fee on the mortgages, which is currently 1 percent, and the recommendation of the administration that it be increased.

While you were out, a review was presented by myself indicating that in the past several years, since 1978, there have been transferred from the Direct Loan Revolving Fund to the Loan Guaranty Revolving Fund, which is a reserve account, or direct supplemental appropriations have been required in the approximate amount of $1.8 billion, which indicates, obviously, that the reserve accounts have been inadequate on the basis of the defaults and the consequences of using those reserve accounts to provide reimbursement to the fund to offset the negative effects of foreclosure and defaults.

So, it is not the intention of the chairman to pursue the question of how much do we realistically need, but rather what changes can be made in the program to reduce foreclosures and reduce the need for increased points on top of the sales amount, because I do not think that is the problem. And I would hope that, from the testimony today, we will get recommendations of changes that should be made in the program and still would not effect the viability of the program nor how beneficial the program has been for the veterans of America.

Do you have any statement that you would care to make at this time?

Senator ROCKEFELLER. I have one I'd like to submit for the record, Mr. Chairman.

In preparation for this, I noticed that you have quite a number of witnesses. Thus, I will submit some questions in written form, because I don't want to disrupt the flow.

Chairman MURKOWSKI. Fine.

I appreciate your accommodation. And your statement, upon submission, will be entered into the record, and questions as well.

[The prepared statements of Hon. John D. Rockefeller IV, a U.S. Senator from the State of West Virginia; Hon. Alan Cranston, ranking minority member of the Senate Committee on Veterans' Affairs; and Hon. George J. Mitchell, a U.S. Senator from the State of Maine follow:]

PREPARED STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM THE STATE OF WEST VIRGINIA

Thank you, Mr. Chairman, for giving me this opportunity to say something about the Home Loan Program for veterans. I'm glad that the Committee decided to conduct this oversight hearing, and to see that so many of my colleagues, VA officials, and representatives of veterans' groups are attending to jointly look into the status of this very important program.

I am especially interested in VA's Home Loan Guaranty Program, because of the pressing housing situation affecting all of the residents of my state, West Virginia. Due to the economic conditions of the past several years, it has been very difficult to enable our younger families to own a home. The veterans' Home Loan Guaranty Program has been one of the few tools we've had to meet this need. And in our state, with 67,000 of our 242,000 veterans having served in the Vietnam War, this program has the potential of giving a significant number of our younger men and women one of their only chances to acquire a decent home of their own.

Thus, I am here with the hope of learning more about the workings of the program, and with particular interest in gaining insights on how we might ensure its future solvency and vitality.

I would assume that my state's experiences with the program are similar to most others. I know that the nine government employees staffing our VA Regional Office in Huntington are hard-working, dedicated workers, who have very positive relationships with bankers, housing officials and veterans groups. I am especially proud of helping to create a now highly effective partnership between the state's housing authority and its VA home loan division. We were successful in obtaining the housing authority's agreement to finance a sizeable proportion of VA loans in such a way that our veterans get a further break in interest rates and can generally avoid having to make a down payment. This arrangement now serves about half of the West Virginia veterans who get VA home loans a year, and is viewed as a great success by all parties.

Our veterans have been affected as much or worse than those nationwide by larger economic problems. The combination of rising interest rates, housing costs and unemployment have taken a very serious toll on them. We've, therefore, had our full share of default problems, as well, in the housing area. I must stress, however, that in almost every case, a veteran suddenly unable to meet his loan payments does everything possible to drum up the money because that home is so critical to his family's well-being.

I am very concerned with the Administration's proposals to increase the so-called "user fee" which would, in effect, impose a hefty tax on veterans seeking to own a home. I see that the testimony of the various witnesses address this proposal in detail. But I am especially interested in getting an explanation from the VA, and most of all David Stockman, regarding the rationale for this fee and the discrepancy between its analysis of the future of the program and CBO's analysis. The mortgage bankers, for example, in my state say in no uncertain terms that the fee would prevent most veterans from taking advantage of the program -- they just can't and won't meet the up-front and long-term costs that the fee entails. Thus, deserving veterans won't be able to obtain a home.

In general, I am interested in doing everything possible to sustain this vital program. Along with my colleagues, I am perfectly willing to focus on the details of a program as technical as this one is and work on fixing problems of whatever nature. But I strongly oppose any efforts to undermine the basic purpose and commitment underlying the Home Loan Program and will fight off the user fee and any other bad ideas that come before us that have nothing to do with revitalizing the financial shape of the program. I owe that much to our veterans.

PREPARED STATEMENT OF HON. ALAN CRANSTON, RANKING MINORITY MEMBER OF THE SENATE COMMITTEE ON VETERANS' AFFAIRS

MR. CHAIRMAN, I'M DELIGHTED TO JOIN IN WELCOMING ALL THE WITNESSES AND GUESTS AT THIS MORNING'S HEARING ON THE V.A.'S HOME LOAN GUARANTY PROGRAM.

I'M VERY PLEASED THAT THE COMMITTEE IS EXERCISING ITS OVERSIGHT RESPONSIBILITIES AT THIS TIME. THIS PROGRAM, WHICH HAS SERVED NEARLY 12 MILLION VETERANS SINCE ITS INCEPTION AFTER WORLD WAR II, IS AN IMPORTANT ONE, AND THE OPERATION OF IT IN A MANNER WHICH WILL CONTINUE TO MEET THE NEEDS OF VETERANS IS IMPERATIVE.

I SHARE COMPLETELY THE CONCERNS OF THE CHAIRMAN AND MANY OTHERS ABOUT THE SOLVENCY OF THE LOAN GUARANTY REVOLVING FUND. THAT'S ONE OF THE REASONS WHY I WAS DEEPLY INVOLVED LAST YEAR IN DEVELOPING LEGISLATION, WHICH WAS ENACTED IN SECTIONS 2511 AND 2512 OF THE DEFICIT REDUCTION ACT OF 1984, TO HELP ENSURE THAT THE FUND REMAINS SOLVENT.

I'M DISMAYED BY THE ADMINISTRATION'S PROJECTIONS OF THE NEED FOR APPROPRIATIONS OF OVER $400 MILLION TO THE REVOLVING FUND IN F.Y. 86. THOSE PROJECTIONS SEEM TO INDICATE THAT THE LEGISLATION ENACTED LAST YEAR HAS HAD VERY LITTLE IMPACT. YET, THE CONGRESSIONAL BUDGET OFFICE HAS REJECTED THESE ESTIMATES OF APPROPRIATIONS REQUIREMENTS, FINDING INSTEAD THAT NO APPROPRIATIONS TO THE FUND WILL BE NEEDED THROUGH FISCAL YEAR 1990. I SEE NO BASIS FOR NOT ACCEPTING C.B.O.'S ANALYSIS.

NEVERTHELESS, I BELIEVE THAT WE NEED TO EXPLORE ALL ISSUES RELATING TO WHETHER THERE ARE PROBLEMS IN THE V.A.'S HOME-LOAN GUARANTY PROGRAM THAT ARE OR COULD BE CAUSING A DRAIN ON THE REVOLVING FUND, AND

WE NEED TO IDENTIFY ANY SUCH PROBLEMS THAT EXIST AND PURSUE THE APPROPRIATE ACTIONS NECESSARY TO RESOLVE THEM. IF, FOR EXAMPLE, IMPROVEMENTS IN THE V.A.'S APPRAISAL PROCESS COULD RESULT IN A REDUCED COST TO THE FEDERAL GOVERNMENT IN THE CASE OF FORECLOSURES ON V.A.-GUARANTEED LOANS, THOSE IMPROVEMENTS AND ADJUSTMENTS SHOULD BE MADE AS LONG AS THEY STILL PRODUCE FAIR VALUATIONS. IF THERE ARE STEPS THAT COULD BE TAKEN TO REDUCE THE HIGH DEFAULT AND FORECLOSURE EXPERIENCE OF THE V.A., WE NEED TO FIND OUT WHAT THEY ARE AND HOW IMPROVEMENTS THERE MIGHT BE MADE THAT COULD NOT ONLY BENEFIT THE VETERAN HOME-OWNER, BUT ALSO THE FEDERAL GOVERNMENT AND ALL AMERICAN TAXPAYERS.

I WANT TO TAKE A MOMENT TO EXPRESS A NOTE OF FRUSTRATION. I BELIEVE WE ARE BEING SEVERELY HAMPERED IN OUR CONSIDERATION OF THE ISSUES IN THIS AREA BY THE FAILURE OF THE ADMINISTRATION TO BE COMPLETELY FORTHCOMING AND FORTHRIGHT WITH RESPECT TO VARIOUS PIECES OF INFORMATION.

FROM THE DATE ON WHICH THE F.Y. 86 BUDGET PROJECTING A NEED FOR SUCH A LARGE APPROPRIATION TO THE FUND WAS SUBMITTED BY THE PRESIDENT, THE ADMINISTRATION'S PRIMARY CONCERN IN THIS AREA HAS BEEN TO JUSTIFY ITS PROPOSAL TO INCREASE THE LOAN GUARANTY FEE, FIRST TO 5 PERCENT AND, MORE RECENTLY, TO 3.8 PERCENT. ALTHOUGH THE FEE-INCREASE PROPOSAL IS NOT SPECIFICALLY ON THE AGENDA FOR THIS HEARING, THE ADMINISTRATION'S PERSISTENT DESIRE TO HAVE AN INCREASE ENACTED IS PART OF THE ENVIRONMENT IN WHICH WE MUST EXAMINE THE LOAN GUARANTY PROGRAM. WE MUST EVALUATE THE ADMINISTRATION'S ASSESSMENTS OF THE CURRENT SITUATION AGAINST THE BACKDROP OF ITS STATEMENTS AND POSITIONS RELATING TO THE LOAN GUARANTY FEE. IN SHORT, THE ADMINISTRATION HAS A CLEAR BIAS AND WE NEED TO BE AWARE OF IT.

THUS, WE NEED TO BE AWARE THAT, ALTHOUGH THE ADMINISTRATION HAS CLAIMED THAT THE FEE INCREASE WAS TO PROTECT THE FUND FROM SHORTFALLS

RESULTING FROM DEFAULTS, ITS OWN DATA SHOW THAT ITS INTENTION HAS BEEN TO ACCUMULATE A NEARLY $2 BILLION EXCESS IN THE LOAN GUARANTY FUND OVER THE NEXT FIVE YEARS.

AT THE SAME TIME, THE ADMINISTRATION PROPOSED TO EXACERBATE WHATEVER DIFFICULTIES THE FUND MAY ENCOUNTER BY ELIMINATING THE V.A.'S LONG-HELD DISCRETION TO TRANSFER AMOUNTS FROM THE DIRECT LOAN REVOLVING FUND, WHERE THEY ARE NOT NEEDED, TO THE LOAN GUARANTY REVOLVING FUND, WHERE THEY ARE. I SEE NO REASON FOR THIS PROPOSAL EXCEPT AS IT PLAYS A PART IN THE ADMINISTRATION'S OVERALL EFFORT TO DEVELOP THE APPEARANCE OF A NEED TO INCREASE THE FEE. BOTH THE ADMINISTRATION'S AND C.B.O.'S PROJECTIONS SHOW THAT, OVER THE NEXT FIVE YEARS, THERE WILL BE A TOTAL OF ABOUT $200 MILLION IN THE DIRECT LOAN FUND, WHICH UNDER A CUSTOMARY PROVISION IN THE V.A.'S ANNUAL APPROPRIATION LAWS WOULD BE AVAILABLE TO MEET ANY SHORTFALLS IN THE LOAN GUARANTY REVOLVING FUND.

THIS IS WHY I AM PROPOSING PERMANENT STATUTORY AUTHORITY FOR INTER-FUND TRANSFERS AND WILL SHORTLY INTRODUCE LEGISLATION TO PROVIDE THAT AUTHORITY.

PERHAPS THE CLEAREST EXAMPLE OF THE ADMINISTRATION'S AND O.M.B.'S BIAS REGARDING THE LOAN GUARANTY PROGRAM WAS THE ADMINISTRATION'S LUDICROUS POSITION TAKEN IN FEBRUARY THAT THE IMPOSITION OF A 5-PERCENT FUNDING FEE WOULD HAVE NO EFFECT ON THE NUMBERS OF VETERANS USING THEIR V.A. HOME-LOAN ENTITLEMENTS. AS EVERYONE BUT THE ADMINISTRATION WOULD ACKNOWLEDGE, THE FACT IS THAT A 5-PERCENT FEE WOULD HAVE PREVENTED HUNDREDS OF THOUSANDS OF VETERANS, PRINCIPALLY VIETNAM-ERA VETERANS, FROM USING THEIR GUARANTY ENTITLEMENT OVER THE NEXT 5 YEARS. MOREOVER, WHEN CHALLENGED AT HEARINGS IN BOTH HOUSES, THE ADMINISTRATION PERSISTED IN ITS IMPOSSIBLE PREDICTION.

FINALLY, DURING THE PAST FEW WEEKS -- AFTER THE SENATE BUDGET COMMITTEE TWICE REJECTED THE INCREASE TO 5 PERCENT, FIRST, BY A VOTE

ON A MOTION BY SENATOR CHILES FOR A V.A. BUDGET WITH NO FEE INCREASE AT ALL AND, NEXT, BY ADOPTING A BUDGET PACKAGE PROPOSED BY SENATOR DOMENICI WITH THE FEE REDUCED TO 3.8 PERCENT -- THE ADMINISTRATION RECOGNIZED THE FUTILITY OF PURSUING ITS 5-PERCENT FEE PROPOSAL. HOWEVER, IT IS STILL SEEKING TO DOUBLE THE FEE AS OF OCTOBER 1 OF THIS YEAR AND TO RAISE IT TO 3.8 PERCENT BY 1990.

REGRETTABLY, THE ADMINISTRATION'S OVERRIDING DESIRE TO USE A FEE INCREASE AS A DEFICIT-REDUCTION MEASURE HAS PROVIDED REASON TO VIEW ANY OF ITS ASSERTIONS REGARDING THE LOAN GUARANTY PROGRAM WITH SUSPICION. THAT IS MOST REGRETTABLE. WE COULD BE MUCH MORE EFFECTIVE AND PRODUCTIVE IN ADDRESSING ANY PROBLEMS IN THE PROGRAM IF THE PROBLEM WERE FRAMED HONESTLY, THE ANSWERS WERE GIVEN OPENLY AND CORRECTLY TO THE EXTENT THAT THEY ARE AVAILABLE, AND THE WHOLE UNDERLYING ISSUE -- THE SOLVENCY OF THE REVOLVING FUND -- WERE NOT USED ILLEGITIMATELY AS A MEANS OF DEFICIT REDUCTION.

HAVING EXPRESSED THESE DOUBTS AND FRUSTRATIONS, I'LL CLOSE BY ALSO EXPRESSING MY HOPE THAT THESE HEARINGS WILL BE PRODUCTIVE AND THAT IT WILL BE POSSIBLE FOR US, WORKING TOGETHER AND WITH THE HELP OF TODAY'S WITNESSES, TO IDENTIFY AND MOVE TOWARD APPROPRIATE SOLUTIONS IN A PRODUCTIVE AND EFFECTIVE FASHION. I LOOK FORWARD TO RECEIVING ALL WITNESSES' TESTIMONY THIS MORNING AND TO HAVING THE BENEFIT OF THEIR VIEWS AND SUGGESTIONS.

PREPARED STATEMENT OF HON. GEORGE J. MITCHELL, A U.S. SENATO
FROM THE STATE OF MAINE

I want to welcome the witnesses who will present their views this morning on various aspects of the Veterans Administration Home Loan Guaranty Program.

Along with the GI Bill, this program was created by Congress as a readjustment benefit for World War Two veterans roughly 40 years ago. It ranks as one of the most significant and successful veterans benefit programs, one that has made the American dream of homeownership a reality for millions of veterans over the past decades. It is a program woth maintaining, worth strengthening to the fullest extent possible.

The purpose of today's hearing is two-fold. First to examine the Administration's proposal, as included in the President's FY86 Budget to increase the present one percent user fee for the program to five percent in order to cover projected shortfalls in the program's Loan Guaranty Revolving Fund.

I oppose that proposal as both unneccessary and detrimental to the interests of eligible veterans who hope to utilize their eligibility for the program to purchase a home. I expressed that view along with the Committee's other Minority Members in our seperate views to the Budget Committee in March.

The second broad subject area to be covered in today's hearing, partially in closed session with the VA Inspector General, is the VA's management of the loan guaranty program in the face of continuing high default rates and the mounting federal deficit. I look forward to receiving the views fo today's witnesses on that subject so that this Committee can evaluate the effectiveness of the VA's efforts in this regard.

Mr. Chairman, I regret that I will be unable to stay for the complete hearing this morning. The Enviornment and Public Works Committee is marking up the Clean Water Act at this time, and my presence is required at that hearing.

I apologize to the witnesses in advance. I will closely review their prepared statements. I look forward to working with the Chairman and the distinguished ranking member in fashioning appropriate Committee action that should follow this oversight hearing today.

Chairman **Murkowski**. I would also like to place in the record at this point written statements of Hon. Strom Thurmond, a U.S. Senator from the State of South Carolina, and Hon. Jeremiah Denton, a U.S. Senator from the State of Alabama.

[The prepared statements of Hon. Strom Thurmond, a U.S. Senator from the State of South Carolina, and Hon. Jeremiah Denton, a U.S. Senator from the State of Alabama, follow:]

PREPARED STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR FROM THE STATE OF SOUTH CAROLINA

MR. CHAIRMAN:

It is a pleasure to be here today to receive testimony regarding the operation of the Veterans Administration Home Loan Guaranty Program.

I commend you, Mr. Chairman, for scheduling this oversight hearing. The VA Home Loan Guaranty Program is a very important program--one which has helped millions of veterans realize the American dream of home ownership. Since enactment as part of the G.I. Bill of 1944, the VA Home Loan Guaranty Program has provided mortgage credit assistance to over 11.4 million veterans at a value of $234 billion. Only 4% of VA-guaranteed home loans have fallen into foreclosure.

However, the recession of 1980-1982 brought difficult times for the program. During this period of high interest rates and high unemployment, the number of defaults and foreclosures on VA-guaranteed home loans rose steadily, placing a serious strain on the Loan Guaranty Revolving Fund.

Mr. Chairman, it is particularly distressing that, in the current period of economic recovery, the VA continues to experience a high rate of defaults and foreclosures. During 1983 and 1984, the average number of foreclosures was more than 2,000 per month. By comparison, the average number of foreclosures per month reported in fiscal year 1980 was 1,000.

The high level of foreclosures has combined with slow resales of VA-acquired properties to cause the Loan Guaranty Revolving Fund to run deficits. Historically, when the Loan Guaranty Revolving Fund required additional funds to maintain operations, the VA transferred funds from its Direct Loan Revolving Fund. However, the Administration in 1981 instructed the VA to discontinue direct loan activity, and, as a consequence, the Direct Loan Revolving Fund has a reduced capacity to provide funds for the Loan Guaranty Revolving Fund.

Mr. Chairman, the collection of a 1% loan origination fee and appropriations have been necessary in recent years to maintain the solvency of the VA Home Loan Guaranty Program. In fiscal year 1984, a supplemental appropriation of $100 million was required, and an additional $160 million in budget authority was transferred to the Loan Guaranty Revolving Fund from the Readjustment Benefits Account. For fiscal year 1985, $306.6 million has already been appropriated to meet the expected needs of the program. Furthermore, the fiscal year 1986 budget request of the Administration estimates that the VA will require $404.6 million in appropriations to meet the needs of the program.

In view of the absolute necessity to reduce the soaring Federal budget deficit, Congress faces the difficult challenge of weighing competing demands for limited resources. It is time to examine carefully all areas of the VA Home Loan Guaranty Program, with a view toward identifying and correcting problems contributing to the near insolvency of the program. The VA Home Loan Guaranty Program has worked well for our deserving veterans over the years, and it is our obligation to ensure that it continues to do so.

Mr. Chairman, we have a distinguished list of witnesses here today, and I look forward to a careful review of the testimony.

PREPARED STATEMENT OF HON. JEREMIAH DENTON, A U.S. SENATOR FROM THE STATE OF ALABAMA

MR. CHAIRMAN, I AM PLEASED TO BE HERE THIS MORNING FOR THE SENATE COMMITTEE ON VETERANS AFFAIRS HEARING ON THE VETERANS ADMINISTRATION'S HOME LOAN GUARANTY PROGRAM. IT IS A SENSITIVE SUBJECT FOR VETERANS, THE VA, AND THE SENATE, AND I AM GLAD THAT WE ARE ADDRESSING THE ISSUE. I AM A STRONG SUPPORTER OF THE LOAN GUARANTY PROGRAM. IT HAS ENABLED HUNDREDS OF THOUSANDS OF VETERANS TO PURCHASE HOMES. IT HAS STIMULATED THE HOUSING INDUSTRY NATION-WIDE, AND HAS SUBSTANTIALLY RAISED THE OVERALL STANDARD OF LIVING. BUT, AS WE ALL KNOW, THE PROGRAM HAS RUN INTO DIFFICULTIES, AND I THINK THAT IT IS TIME FOR US TO TAKE A CLOSE LOOK AT THE HOME LOAN GUARANTY PROGRAM, WHICH IS IN SEVERE TROUBLE.

SINCE ITS ENACTMENT AS A PART OF THE SERVICEMAN'S' READJUSTMENT ACT OF 1944, THE VA HOME LOAN GUARANTY PROGRAM HAS GUARANTEED OVER 11.4 MILLION HOME LOANS AT A VALUE OF $234 BILLION. THE VA CURRENTLY OWNS 21,000 PROPERTIES, AND AN ADDITIONAL 11,000 PROPERTIES ARE PENDING VA ACQUISITION. IN ADDITION, THE VA HAS A DIFFICULT TIME RESELLING THE PROPERTIES, AND HAS NEARLY 13,000 THAT HAVE BEEN HELD IN EXCESS OF SIX MONTHS.

THE VA OWNS THE PROPERTIES AS A RESULT OF THE INCREASING NUMBER OF DEFAULTS. IN 1979, NEW DEFAULTS AVERAGED 10,000 PER MONTH. IN FY 1984, NEW DEFAULTS AVERAGED 13,000 PER MONTH. FOR THE FIRST HALF OF FY 1985, HOWEVER, THERE WAS NO DECREASE IN THE DEFAULT RATE FROM THE PREVIOUS YEAR. THE HIGH RATE OF DEFAULTED LOANS HAS AN EFFECT ON THE NUMBER OF FORECLOSURES, WHICH HAS INCREASED FROM FEWER THAN 1000 PER MONTH IN 1980 TO OVER 2,000 PER MONTH DURING THE LAST TWO YEARS.

IT IS OBVIOUS THAT SUCH A HIGH FORCLOSURE RATE, COUPLED WITH SLUMPING PROPERTY SALES, HAS DEPLETED THE RESERVES OF THE LOAN GUARANTY REVOLVING FUND. THE FUND WAS INTENDED TO BE SELF-SUFFICIENT, BUT IT HAS NOT BEEN. SUPPLEMENTAL APPROPRIATIONS IN FY 1984 AND FY 1985 OF $100 MILLION AND $307 MILLION, RESPECTIVELY, WERE NEEDED TO SUSTAIN ITS SOLVENCY. IT IS ESTIMATED THAT $407 MILLION IN APPROPRIATIONS WILL BE NEEDED IN FY 1986.

WE ARE THUS FACED WITH A SITUATION THAT REQUIRES EITHER A SMALL INCREASE IN THE HOME LOAN USER FEE, OR MAMMOTH APPROPRIATIONS FROM THE FEDERAL GOVERNMENT TO MAINTAIN THE SOLVENCY OF THE REVOLVING FUND.

THE PURPOSE OF THIS HEARING IS TO EXPLORE THESE ALTERNATIVES TO HELP US DETERMINE THE BEST WAY TO KEEP THE FUND IN A CONDITION THAT ALLOWS IT TO CONTINUE TO SERVE OUR VETERANS.

THANK YOU, MR. CHAIRMAN.

Chairman MURKOWSKI. Mr. O'Toole, with reference to the other members of the panel, do they have any statements that they would like to make?

Mr. O'TOOLE. No, they don't, Mr. Chairman, but they're available to answer any questions you might have.

Chairman MURKOWSKI. Mr. O'Toole, I think that your presentation has been certainly a positive one. I guess what I was looking a little more for was reference to what the problems are, as you see them within the program and what suggestions you might or your colleagues might make. You work the program, you see the inconsistencies in it, just as there are inconsistencies in any program.

Do you have any comments on what those problems might be?

Mr. O'TOOLE. Well, Mr. Chairman, I think it's important to note as you know, better than I do, the reason we're in this financing difficulty is because of the economic problems in the country in the early 1980's.

And fortunately our program has not suffered any more severely the impact of those difficult economic times than the conventional mortgage industry or FHA.

Unfortunately, we haven't moved out of that difficulty as fast as we had anticipated. We feel that the way to reduce the need for additional appropriation, of course, is to convert the assets that we have in the form of these inventory of houses to cash. We feel we're doing that. We're making reasonably good progress in moving that inventory.

Chairman MURKOWSKI. Do you know what the delinquency rate is for conventional loans, Mr. O'Toole?

Mr. O'TOOLE. No. Offhand, I don't.

Chairman MURKOWSKI. Do you know what it is for VA loans?

Mr. O'TOOLE. Approximately 4.5 percent.

Chairman MURKOWSKI. According to data compiled by the Mortgage Bankers Association, dated November 28, 1984, VA loans were 6.63 percent—delinquency. And conventional loans are 2.76 percent.

I would be happy to have you provide a correction on those figures if you think there is a discrepancy.

Mr. O'TOOLE. Well, I'm not sure where the MBA gets their figures, Mr. Chairman. But I think that same report also indicates that the rate of increase in defaults is higher on conventional loans than it is on VA loans.

Chairman MURKOWSKI. I do not think either one of us want to reflect on what some other loan program is necessarily doing. But as a matter of record, I would ask that the staffs examine and obtain authoritative figures on conventional loan delinquencies and VA loan delinquencies.

Since you brought it up, I think we ought to compare.

[Subsequently, the Veterans' Administration submitted the following information:]

The November 28, 1984, MBA Delinquency Survey showed that, for the 3rd quarter of calendar year 1984, 4.02 percent of all conventional loans were past due; the comparable figure for VA-guaranteed loans was 6.63 percent. The survey also showed that the conventional loan delinquency rate in the 30 days past due category was 2.76 percent, while the VA-guaranteed loan delinquency rate was 4.53 percent in that category.

Chairman MURKOWSKI. Realistically, in 1982, according to the figures in 1982, the indication was that VA loans showed a delinquency of about 5.9 percent in 1983. They averaged over 6 percent, as compared to conventional, which, in 1982, averaged 3.8 percent; in 1983, about 3.9 percent.

You made a statement that I would like to discuss in a little more detail. You indicated that, like other programs associated with the employment fluctuations in the country, the VA foreclosures have increased during that same period.

I have a chart here that shows a very interesting trend—and it was provided by the VA. It is a little difficult to perhaps see. In the blue area, it shows foreclosures.

You can see the foreclosures in 1976 declined pretty well until 1980, and then they hit a low in the number of foreclosures—about, oh, 7,500 or thereabout.

And then, in 1981, they really started to move up—1981, 1982, 1983, and 1984. And in 1984, the foreclosures were somewhere, of, around a little over 12,000, which is the figure you gave.

But this green line is the one that is kind of interesting, because the green line is the employment line. The green line indicates that the—well, this is the actual unemployment rate. The unemployment rate somewhat followed the foreclosure rate, and it went up.

But in 1983, the unemployment went down. It started down and went down from a high of a little over 10 percent to approximately 7 percent. But the VA foreclosure rate went way up, almost out of sight.

Now, I do not understand that correlation, because it would seem that it would conflict with your statement, that implies that VA foreclosures have followed unemployment in the country, when this chart provided by you shows just the opposite, in rather startling detail.

Mr. O'TOOLE. Well, Senator, I think you also have to remember that it takes a long time after people get back to work, to recover and to continue to make the mortgage payments.

We've seen a number of situations where, although people have returned to work, their income is not what it was at the time some of these loans were made. So, they're not able to continue, even though they're back to work.

And employment is up, certainly. But they're not able to continue the high mortgage payments that are on these loans that were made when incomes were quite a bit higher.

I think, if you'll look at the same chart—my chart doesn't have the different—Mr. Chairman, what is this line?

Chairman MURKOWSKI. That is the unemployment rate.

Mr. O'TOOLE. That's the unemployment rate?

Chairman MURKOWSKI. Yes.

Mr. O'TOOLE. Well, I think it probably indicates that it took a while for the foreclosures to increase even though the unemployment rate was fairly high during 1979 and early 1980, foreclosures were not very high during that time, as you indicated.

So, it takes a while, first of all, for foreclosures to go up after high rates of unemployment, and it also takes a while for the foreclosures to come down after employment rates go up.

Chairman MURKOWSKI. I certainly do not disagree with that point.

The question is, you know, have we seen the turnaround, or is it still going the other way?

And tell me, upon a foreclosure, what is the VA procedure in the sense of the mechanics? I would be interested to have you walk me through the average VA home loan. I assume it is somewhere in the area of $60,000.

Mr. O'TOOLE. A little bit higher than that.

Chairman MURKOWSKI. Why don't you take us through the exercise so we all understand the procedure.

The veteran comes to his bank and says, "I have found a house, and I want a VA mortgage."

Mr. O'TOOLE. All right.

Chairman MURKOWSKI. Please feel free to call on your colleagues as we walk through the process.

Mr. O'TOOLE. All right.

That's what happens. The veteran finds a house that he or she wants to purchase. And most likely the real estate agent will——

Chairman MURKOWSKI. Well, first of all, I am going to interrupt in this process. Is it likely that he is dealing with a real estate agent?

Mr. O'TOOLE. Most likely.

Chairman MURKOWSKI. Why?

Mr. O'TOOLE. Because that's what normally happens in the purchase of residence.

Chairman MURKOWSKI. I get a little different rumbling, that the real estate agents as a whole do not necessarily push VA inventory, because that is the last thing they push. Is that a fair observation?

Mr. O'TOOLE. Well, I think we have to remember we're not now talking about the VA inventory of houses that we've acquired through foreclosure that we're trying to sell. We're talking about——

Chairman MURKOWSKI. OK.

Mr. O'TOOLE [continuing]. Somebody getting a new guaranteed loan.

Chairman MURKOWSKI. The point is that you are in competition with yourself, in one respect——

Mr. O'TOOLE. Well, I don't——

Chairman MURKOWSKI [continuing]. In the sense that you've got an inventory of some-odd thousand homes and another 11,000 going into the inventory that you're trying to unload—at the same time, the realtor is probably not trying to sell one of those, but sell another one.

Mr. O'TOOLE. Well, except that all those homes that we sell are sold through agents, though not necessarily realtors.

The private sector broker, we pay——

Chairman MURKOWSKI. Foreclosures do not generally go through a realtor?

Mr. O'TOOLE. They all go through brokers.

Chairman MURKOWSKI. They all go through brokers?

Mr. O'TOOLE. That's right, Senator.

Chairman MURKOWSKI. I see.

Now, is the commission the same?

Mr. O'Toole. The commission is 5 percent.

Chairman Murkowski. OK.

But we would assume that the commission is probably higher on the non-VA-foreclosed house?

Mr. O'Toole. Well, it most likely is in some areas, but it's a little different arrangement, in that we pay the full commission, there's no other agent involved, there's no reason to split the commission.

Chairman Murkowski. OK. The point I want to make is that the veteran who walks in to the VA and says, "I've found a home," he has probably found it through a real estate agent.

Mr. O'Toole. Most likely.

Chairman Murkowski. And the real estate agent probably has a higher commission on that home than he—than the real estate agent would have on the VA inventory foreclosure homes?

Mr. O'Toole. The total amount of the commission would be higher.

Chairman Murkowski. Thank you.

I am going to interrupt for a moment to accommodate Senator Specter, who is committed to a hearing and has an opening statement as well as some questions.

And the record will be open, Senator.

Senator Specter. Thank you very much, Mr. Chairman, for yielding to me for just a moment.

I want to commend you for having these very important hearings. They are vital, nationwide, and certainly no place more important than the State of Pennsylvania, where veterans have had so many problems with foreclosures, among other economic burdens, because of the high unemployment rate in my State.

So, I thank you for convening these hearings, Senator Murkowski.

And I have some questions to be answered in due course for the record, and I would not interrupt it further at this point—but say that I am leaving only because of conflicting appointments.

As you ladies and gentlemen may know, there are many commitments which we have in committees and subcommittees at the same time, but I did want to be here, albeit briefly, to express my support for this very important hearing.

Thank you, Mr. Chairman.

Chairman Murkowski. Thank you very much.

I might just share with you, as I did with Senator Rockefeller, you know, we have been debating the appropriateness of the increased fee for operation of the reserve account, and the administration has recommended to 5 points, and we are down to 3.8, percent to be phased-in over a 5-year period. But it is rather interesting to note that since 1978 the VA has required account transfers and direct appropriations for the inadequacy of the reserve account to the tune of $1.9 billion.

So, obviously, the point structure has not been realistic in any manner of form. And I do not think that by adding points to it you necessarily cure the problem.

I think that, hopefully, we will have recommendations from others who would suggest there is some other way out of this dilemma.

Senator Specter. It certainly is a major problem, not adequately addressed at the moment; I agree.

Thank you, Mr. Chairman.

Chairman Murkowski. Thank you very much, Senator Specter. I apologize for the interruption, but appreciate your bearing with us.

OK. We have concluded, then, that there is a greater incentive to sell homes by a realtor other than a non-VA-foreclosed home, so that the individual has come in now and come to the VA and said, "I have got a home," and the VA starts the process.

Please proceed.

Mr. O'Toole. All right.

Well, Mr. Chairman, the first thing they would most likely do is that veteran would be referred to somebody in the community who would make the VA loan, a mortgage banker or a savings and loan or a bank, and then the process would begin.

The mortgage lender would order——

Chairman Murkowski. Now, what is the average price of this house, first of all?

Mr. O'Toole. The average price is about $70,000.

Chairman Murkowski. About $70,000.

OK. And the first bank says, "We will"—what?—"make the loan" or "consider the applicant" or?

Mr. O'Toole. Well, they would probably do a preliminary analysis of the applicant's credit history and income.

Chairman Murkowski. All right.

Now, who—does the VA direct the applicant to the bank?

Mr. O'Toole. No; that's all done by the veteran, most likely working with the real estate agent, who has had some dealings with this lender in the past.

Chairman Murkowski. So, the realtor would take the preliminary contract to the bank. OK.

Mr. O'Toole. And then normally, the preliminary application would be completed, showing income and credit obligations and those sorts of things. And that would be reviewed by the lender.

Chairman Murkowski. All right.

Mr. O'Toole. And the lender would make an early determination without any verification that they'd be willing to make this loan.

Chairman Murkowski. Yes; so, you can say the lender approves the creditworthiness of the borrower?

Mr. O'Toole. Early on, there's a preliminary creditworthiness check, yes.

Chairman Murkowski. OK.

Mr. O'Toole. Then, the next thing that would happen——

Chairman Murkowski. Now, are those credit applications reviewed by the VA?

Mr. O'Toole. Well, they could be, as we move down in the process of processing this application. But this is just a——

Chairman Murkowski. Who approves the loan application—who makes the decision that this borrower is creditworthy?

Mr. O'Toole. Either the lender, if they have what we call automatic authority, that we've given them, or the VA, if the lender wants to submit that case to the VA.

But it's not at that point

Chairman Murkowski. Is there any—OK, we are not at that point. Go ahead.

Mr. O'Toole. All right.

So, after this preliminary analysis is done, the lender would then order an appraisal on the property, then they would call our office, in most likelihood, and get the assignment of a fee appraiser, somebody who is on a panel of fee appraisers.

And at the time the appraiser is——

Chairman Murkowski. All right. Let's stop there—please.

OK. The lender then orders the appraisal through VA?

Mr. O'Toole. That's right.

Chairman Murkowski. The lender does not do the appraisal?

Mr. O'Toole. That's right.

Chairman Murkowski. And VA has fee appraisers?

Mr. O'Toole. Yes, Mr. Chairman.

Chairman Murkowski. Where are they, all over the country?

Mr. O'Toole. Yes.

Chairman Murkowski. How many have they got?

Mr. O'Toole. About 20,000.

Chairman Murkowski. 20,000.

[Subsequently, the Veterans' Administration submitted the following information:]

There are approximately 7,000 active fee appraisers currently used by the VA.

Mr. O'Toole. These are professional appraisers who do work for us and for other lenders.

Chairman Murkowski. What is their requirement for professional designation—are they MAI's?

Mr. O'Toole. A lot of them are MAI's. A lot of them are SRA's. They have to meet the qualifications that——

Chairman Murkowski. What are the qualifications of the VA for fee appraisers?

Mr. O'Toole. Mr. Chairman, I can provide that.

[Subsequently, the Veterans' Administration submitted the following information:]

Appraisers must meet the basic agency qualifications as defined in VAR 4339:

"To qualify for approval as a designated fee appraiser, an applicant must show to the satisfaction of the Administrator that his or her character, experience, and the type of work in which he or she has had experience for at least five years qualifies him or her competently to appraise and value within a prescribed area the type of property to which the approval relates."

Every effort is made to only designate as fee appraisers individuals who specialize in real estate appraisals, and are not associated with the origination of VA loan applications. An applicant must also submit at least three letters of reference and at the option of field station management, pass a written test. The applicant is reviewed against a conflict of interest standard which precludes federal employees, or any employment situation which may result in a conflict between the private interests of the appraiser and the interest of the VA and veterans.

Field station directors may also remove fee appraisers for malfeasance, engaging in practices detrimental to the Government, conduct which may reflect adversely on the VA or for engaging in a conflict of interest situation. Annually fee appraisers are required to sign a general conflict of interest certification. Additionally, each appraisal report contains a conflict of interest statement that relates specifically to the property being appraised.

Assignments are made by field stations to those appraisers who are familiar with the area in which the property is located and who are able to complete the assignment within the time limitations. Stations are cautioned against making assignments which show favoritism or discrimination.

Fee basis appraisers are requested to estimate the reasonable value of residential real estate and/or manufactured homes in light of prevailing conditions. As a practical matter, reasonable value is the same as market value. The appraiser takes into consideration the condition of the property at the time of the appraisal.

In the case of an existing property, the appraiser is required to list those repair items, if any, necessary to make the property conform to the minimum property requirements. These repair requirements are listed on the certificate of reasonable value (CRV). The staff appraiser is responsible for reviewing the fee appraiser's report and issuing the CRV. The reviewer checks for completeness of the report, accuracy of the data presented and the logic of the conclusions.

The performance of the entire active roster of fee personnel is under continuous staff review. In this regard, our present policy requires a minimum of 10 percent of appraisal reports submitted by fee appraisers each month be reviewed by staff personnel.

Mr. O'TOOLE. Essentially, you have to submit a written appraisal report that's reviewed by our office, you have to be——

Chairman MURKOWSKI. Where is that reviewed?

Mr. O'TOOLE. By our regional offices.

Chairman MURKOWSKI. So your regional office would—and who reviews that in your regional office?

Mr. O'TOOLE. Mr. Chairman, are we talking about whether someone is going to be appointed to the panel——

Chairman MURKOWSKI. Yes.

Mr. O'TOOLE [continuing]. Or the individual appraiser report?

Chairman MURKOWSKI. No, who is going to——

Mr. O'TOOLE. The 49 regional offices appoint the panel of fee appraisers based on the application, whether the appraiser meets the required experience requirements, whether they're a full-time appraiser. They have to submit letters of recommendation. They have to submit samples of reports they have submitted to other clients. They essentially have to meet the same experience and qualification requirements.

Chairman MURKOWSKI. You say that some of them are MAI's and some of them are SRA's.

There are, professionally, within the appraising profession, criteria. Why are there two criteria? There is a VA criteria, and then there is a private-sector criteria. And I gather that there is some flexibility, because you said there are others—but MAI's and SRA's.

Mr. O'TOOLE. Well, not everyone belongs to one of those——

Chairman MURKOWSKI. What do the rest of the appraisers belong to?

Mr. O'TOOLE. Well, there are other associations. There are some people that do not choose to belong to a private association who might be good appraisers. And, there are some parts of the country where it's difficult to find appraisers that are members of one of those organizations.

Chairman MURKOWSKI. Are you satisfied with your VA appraising arrangements as they are currently structured?

Mr. O'TOOLE. As a rule, I'm satisfied that we have quality fee appraisers on our panel, but as you can see, with the large number that we have that it takes diligence to review their work on an ongoing basis and take some off and add some.

Chairman MURKOWSKI. Do you feel that the structure internally in the VA system is entirely satisfactory and there is no need for change—either the appraisal or the process?

Mr. O'TOOLE. Well, no, I don't think I said that, Mr. Chairman. There are some things that we can do, certainly, to improve the quality of the appraisal process. That's why we're working with the inspector general now who is doing an analysis of that.

Chairman MURKOWSKI. Why would you work with the inspector general?

Mr. O'TOOLE. Well, because the Administrator asked the inspector general to do an audit of our appraisal operation.

Chairman MURKOWSKI. What did he come up with?

Mr. O'TOOLE. We've only seen an interim report. I understand it has not been seen by the Administrator. So——

Chairman MURKOWSKI. What does it say?

Mr. O'TOOLE. Well, essentially it says that there are some things that we can do internally to improve the quality of the appraisals, but essentially the system in place is adequate and——

Chairman MURKOWSKI. What are you doing to increase the quality of the appraisal?

Mr. O'TOOLE. Well, we're going to make some administrative changes. For example, we're going to require the fee appraisers to submit photographs of the comparables.

Chairman MURKOWSKI. You do not have photographs?

Mr. O'TOOLE. Of the comparables?

Chairman MURKOWSKI. Yes.

Mr. O'TOOLE. No, we do not, Senator.

Chairman MURKOWSKI. Do you have comparables?

Mr. O'TOOLE. Yes, Mr. Chairman.

Chairman MURKOWSKI. I see, but there is no way to check the comparables and you do not have the photographs?

Mr. O'TOOLE. Well, there is by checking to see if that address is the property in that report that sold for that price and we also do field reviews of——

Chairman MURKOWSKI. What other changes are you going to make?

Mr. O'TOOLE. We're going to increase the quality of the audits that we do. The inspector general's audit showed the field reviews done by our salaried personnel could use some enhancement. We're going to increase the quality of those.

Chairman MURKOWSKI. I do not quite understand that statement.

Mr. O'TOOLE. Well, what it showed—once again, this is a preliminary report and it hasn't been reviewed in the agency. But, it found that in reviewing the performance of appraisers, field stations were concentrating more on those loans that went to foreclosure rather than the review they should be doing on those new loans as a means to audit the quality of the field appraisal panel.

Chairman MURKOWSKI. It is certainly a practice in the private sector to have comparative value accompanied by Polaroid pictures, which is obviously something very easy to obtain and not very costly. Has that been implemented at all in the VA program?

Mr. O'TOOLE. No it hasn't.

Chairman MURKOWSKI. Is there any reason for that?

Mr. O'TOOLE. We haven't had the final inspector general's report.

Chairman MURKOWSKI. No, I know, but you have to wait for an inspector general's report——

Mr. O'TOOLE. Well, since it was in——

Chairman MURKOWSKI [continuing]. To make an administrative requirement in the manner in which you review appraisals if it is indeed—if it is in the best interests of the program? Isn't that authority within the VA?

Mr. O'TOOLE. Yes, it is.

Chairman MURKOWSKI. Is there a reason it hasn't been?

Mr. O'TOOLE. No.

Chairman MURKOWSKI. Is it going to be done?

Mr. O'TOOLE. Yes, Mr. Chairman.

Chairman MURKOWSKI. When?

Mr. O'TOOLE. As soon as we can work it through the agency.

Chairman MURKOWSKI. Is not it a matter of sending out a directive?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. Seems like a pretty simple process to me. What circumstances prompted the inspector general's investigation?

Mr. O'TOOLE. My understanding is that he was asked to make the audit by the Administrator.

Chairman MURKOWSKI. Why would Mr. Walters have ordered this audit?

Mr. O'TOOLE. Mr. Chairman, I can only speculate that he had some concern about how we appraise properties.

Chairman MURKOWSKI. Is that an extraordinary end to go to——

Mr. O'TOOLE. I really——

Chairman MURKOWSKI [continuing]. In a Government agency, or is it not more appropriate to look over your administrative procedure and say, well, hell, we ought to be able to figure this out.

Mr. O'TOOLE. I think he wanted to have somebody outside the Department look at it.

Chairman MURKOWSKI. What is the payment to the fee appraisal? Is it a represented percentage of the sale of the home? Is a flat——

Mr. O'TOOLE. It's a fee that we determine that averages about $120.

Chairman MURKOWSKI. It averages $120?

Mr. O'TOOLE. It depends on the jurisdiction and the areas.

Chairman MURKOWSKI. Is it different in different areas?

Mr. O'TOOLE. Yes, Mr. Chairman.

Chairman MURKOWSKI. So, you would pay a flat fee?

Mr. O'TOOLE. We don't pay the fee. The fee is paid by the eventual purchaser or the person selling the home. But, we determine the fee.

Chairman MURKOWSKI. OK. What is the usual practice of who pays the fee? Are part of the closing cost paid by the seller of the home?

Mr. O'TOOLE. If the veteran is under contract it's paid by the veteran. If the veteran is not under contract and the seller just wants to get an appraisal to see what the property may sell for with VA or FHA financing, then it's paid for by the seller.

Chairman MURKOWSKI. What do you mean, "under contract"?

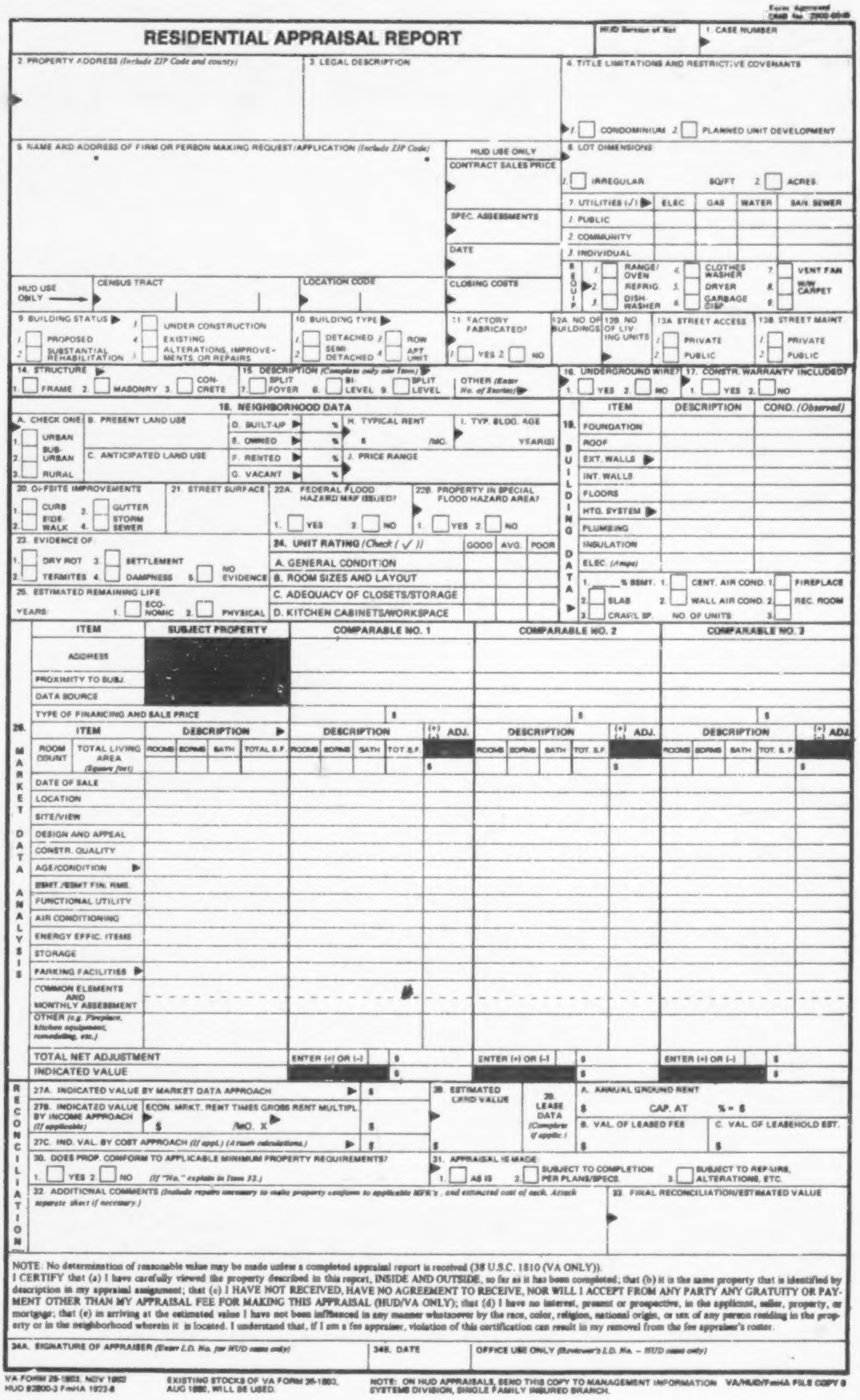
Mr. O'TOOLE. Well, there are some instances where we do an appraisal before the veteran has even signed a contract to buy his home. In some real estate markets the VA appraisal is looked upon as a benchmark valuation, so that agents will recommend to the seller of the property that they obtain a VA certificate of reasonable value at the time the property is listed.

Chairman **Murkowski**. Do you have with you a copy of a VA conventional appraisal form that you have been using for an extended period of time?

Mr. **O'Toole**. I don't have one with me but we can certainly submit a copy.

[Subsequently, the Veterans' Administration submitted the following information:]

Attached is a copy of the Request for Determining of Reasonable Value/Residential Appraisal Report form used by VA and the Department of Housing and Urban Development (HUD).



Form Approved
OMB No. 2900-0045

RESIDENTIAL APPRAISAL REPORT

HUD Section of Act

1. CASE NUMBER ▶

2. PROPERTY ADDRESS *(Include ZIP Code and county)* ▶

3. LEGAL DESCRIPTION

4. TITLE LIMITATIONS AND RESTRICTIVE COVENANTS
▶ 1. ☐ CONDOMINIUM 2. ☐ PLANNED UNIT DEVELOPMENT

5. NAME AND ADDRESS OF FIRM OR PERSON MAKING REQUEST/APPLICATION *(Include ZIP Code)*

HUD USE ONLY
CONTRACT SALES PRICE ▶
SPEC. ASSESSMENTS ▶
DATE ▶
CLOSING COSTS ▶

6. LOT DIMENSIONS ▶
1. ☐ IRREGULAR SQ/FT 2. ☐ ACRES

7. UTILITIES (✓) ▶	ELEC.	GAS	WATER	SAN. SEWER
1. PUBLIC				
2. COMMUNITY				
3. INDIVIDUAL				

8. EQUIP. ▶
1. ☐ RANGE/OVEN 4. ☐ CLOTHES WASHER 7. ☐ VENT FAN
2. ☐ REFRIG. 5. ☐ DRYER 8. ☐ W/W CARPET
3. ☐ DISH-WASHER 6. ☐ GARBAGE DISP. 9. ☐

HUD USE ONLY ⟶ CENSUS TRACT ▶ LOCATION CODE ▶

9. BUILDING STATUS ▶ 1. ☐ PROPOSED 2. ☐ SUBSTANTIAL REHABILITATION 3. ☐ UNDER CONSTRUCTION 4. ☐ EXISTING 5. ☐ ALTERATIONS, IMPROVEMENTS OR REPAIRS

10. BUILDING TYPE ▶ 1. ☐ DETACHED 2. ☐ SEMI DETACHED 3. ☐ ROW 4. ☐ APT. UNIT

11. FACTORY FABRICATED? ▶ 1. ☐ YES 2. ☐ NO

12A. NO. OF BUILDINGS

12B. NO. OF LIVING UNITS ▶

13A. STREET ACCESS 1. ☐ PRIVATE 2. ☐ PUBLIC

13B. STREET MAINT. 1. ☐ PRIVATE 2. ☐ PUBLIC

14. STRUCTURE ▶ 1. ☐ FRAME 2. ☐ MASONRY 3. ☐ CONCRETE

15. DESCRIPTION *(Complete only one Item)* ▶ 7. ☐ SPLIT FOYER 8. ☐ BI LEVEL 9. ☐ SPLIT LEVEL OTHER *(Enter No. of Stories)* ▶

16. UNDERGROUND WIRE? ▶ 1. ☐ YES 2. ☐ NO

17. CONSTR. WARRANTY INCLUDED? ▶ 1. ☐ YES 2. ☐ NO

18. NEIGHBORHOOD DATA

A. CHECK ONE ▶ 1. ☐ URBAN 2. ☐ SUBURBAN 3. ☐ RURAL

B. PRESENT LAND USE

C. ANTICIPATED LAND USE

D. BUILT-UP ▶ %
E. OWNED ▶ %
F. RENTED ▶ %
G. VACANT ▶ %

H. TYPICAL RENT ▶ $ /MO.

I. TYP. BLDG. AGE ▶ YEAR(S)

J. PRICE RANGE ▶

20. OFFSITE IMPROVEMENTS 1. ☐ CURB 2. ☐ SIDEWALK 3. ☐ GUTTER 4. ☐ STORM SEWER

21. STREET SURFACE

22A. FEDERAL FLOOD HAZARD MAP ISSUED? 1. ☐ YES 2. ☐ NO

22B. PROPERTY IN SPECIAL FLOOD HAZARD AREA? ▶ 1. ☐ YES 2. ☐ NO

23. EVIDENCE OF 1. ☐ DRY ROT 2. ☐ TERMITES 3. ☐ SETTLEMENT 4. ☐ DAMPNESS 5. ☐ NO EVIDENCE

25. ESTIMATED REMAINING LIFE
YEARS: 1. ☐ ECONOMIC 2. ☐ PHYSICAL

24. UNIT RATING *(Check (✓))*	GOOD	AVG.	POOR
A. GENERAL CONDITION			
B. ROOM SIZES AND LAYOUT			
C. ADEQUACY OF CLOSETS/STORAGE			
D. KITCHEN CABINETS/WORKSPACE			

19. BUILDING DATA ▶

ITEM	DESCRIPTION	COND. *(Observed)*
FOUNDATION		
ROOF		
EXT. WALLS ▶		
INT. WALLS		
FLOORS		
HTG. SYSTEM ▶		
PLUMBING		
INSULATION		
ELEC. *(Amps)*		

1. ____ % BSMT. 2. ☐ SLAB 3. ☐ CRAWL SP.
1. ☐ CENT. AIR COND. 2. ☐ WALL AIR COND. NO. OF UNITS
1. ☐ FIREPLACE 2. ☐ REC. ROOM 3. ☐

26. MARKET DATA ANALYSIS

ITEM	SUBJECT PROPERTY	COMPARABLE NO. 1		COMPARABLE NO. 2		COMPARABLE NO. 3	
ADDRESS							
PROXIMITY TO SUBJ.							
DATA SOURCE							
TYPE OF FINANCING AND SALE PRICE			$		$		$
ITEM	DESCRIPTION ▶	DESCRIPTION	(+)(–) ADJ.	DESCRIPTION	(+)(–) ADJ.	DESCRIPTION	(+)(–) ADJ.
ROOM COUNT / TOTAL LIVING AREA *(Square feet)*	ROOMS / BDRMS / BATH / TOTAL S.F.	ROOMS / BDRMS / BATH / TOT. S.F.	$	ROOMS / BDRMS / BATH / TOT. S.F.	$	ROOMS / BDRMS / BATH / TOT. S.F.	$
DATE OF SALE							
LOCATION							
SITE/VIEW							
DESIGN AND APPEAL							
CONSTR. QUALITY							
AGE/CONDITION ▶							
BSMT./BSMT FIN. RMS.							
FUNCTIONAL UTILITY							
AIR CONDITIONING							
ENERGY EFFIC. ITEMS							
STORAGE							
PARKING FACILITIES ▶							
COMMON ELEMENTS AND MONTHLY ASSESSMENT							
OTHER *(e.g. Fireplace, kitchen equipment, remodeling, etc.)*							
TOTAL NET ADJUSTMENT		ENTER (+) OR (–)	$	ENTER (+) OR (–)	$	ENTER (+) OR (–)	$
INDICATED VALUE			$		$		$

RECONCILIATION

27A. INDICATED VALUE BY MARKET DATA APPROACH ▶ $

27B. INDICATED VALUE BY INCOME APPROACH *(If applicable)* ECON. MRKT. RENT TIMES GROSS RENT MULTIPL. ▶ $ /MO. X ▶ $

27C. IND. VAL. BY COST APPROACH *(If appl.) (Attach calculations.)* ▶ $

28. ESTIMATED LAND VALUE ▶ $

29. LEASE DATA *(Complete if applic.)*
A. ANNUAL GROUND RENT $ CAP. AT %= $
B. VAL. OF LEASED FEE $
C. VAL. OF LEASEHOLD EST. $

30. DOES PROP. CONFORM TO APPLICABLE MINIMUM PROPERTY REQUIREMENTS?
1. ☐ YES 2. ☐ NO *(If "No," explain in Item 32.)*

31. APPRAISAL IS MADE: ▶ 1. ☐ AS IS 2. ☐ SUBJECT TO COMPLETION PER PLANS/SPECS. 3. ☐ SUBJECT TO REPAIRS, ALTERATIONS, ETC.

32. ADDITIONAL COMMENTS *(Include repairs necessary to make property conform to applicable MPR's, and estimated cost of each. Attach separate sheet if necessary.)*

33. FINAL RECONCILIATION/ESTIMATED VALUE ▶

NOTE: No determination of reasonable value may be made unless a completed appraisal report is received (38 U.S.C. 1810 (VA ONLY)).

I CERTIFY that (a) I have carefully viewed the property described in this report, INSIDE AND OUTSIDE, so far as it has been completed; that (b) it is the same property that is identified by description in my appraisal assignment; that (c) I HAVE NOT RECEIVED, HAVE NO AGREEMENT TO RECEIVE, NOR WILL I ACCEPT FROM ANY PARTY ANY GRATUITY OR PAYMENT OTHER THAN MY APPRAISAL FEE FOR MAKING THIS APPRAISAL (HUD/VA ONLY); that (d) I have no interest, present or prospective, in the applicant, seller, property, or mortgage; that (e) in arriving at the estimated value I have not been influenced in any manner whatsoever by the race, color, religion, national origin, or sex of any person residing in the property or in the neighborhood wherein it is located. I understand that, if I am a fee appraiser, violation of this certification can result in my removal from the fee appraiser's roster.

34A. SIGNATURE OF APPRAISER *(Enter I.D. No. for HUD cases only)*

34B. DATE

OFFICE USE ONLY *(Reviewer's I.D. No. – HUD cases only)*

VA FORM 26-1803, NOV 1982
HUD 92800-3 FmHA 1922-8

EXISTING STOCKS OF VA FORM 26-1803, AUG 1980, WILL BE USED.

NOTE: ON HUD APPRAISALS, SEND THIS COPY TO MANAGEMENT INFORMATION SYSTEMS DIVISION, SINGLE FAMILY INSURED BRANCH.

VA/HUD/FmHA FILE COPY 8

Chairman MURKOWSKI. Obviously we are not going to get through this hearing today, and so it will be recessed and we will continue. But, I would like to have that form.

What information is on the appraisal form that either the financial institution gets or that is given out to the applicant or the lender or——

Mr. O'TOOLE. Well, there are two. There's the appraisal report that's submitted to us and then there's the certificate of reasonable value that we issue to the firm that orders the appraisal. The certificate of reasonable value essentially has our estimate of reasonable value, which is synonymous with market value. The remaining economic life. It has the size of the building. Of course, the address and it has——

Chairman MURKOWSKI. It has got the square footage, then, at the address, independent valuation. Essentially, that is what is on the certificate.

Mr. O'TOOLE. And the expiration date.

Chairman MURKOWSKI. Are there any comparable sales in the appraisal commitment?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. Are there any comparable sales in the area attached?

Mr. O'TOOLE. That's on the appraisal report that is submitted to us and we just recently implemented a procedure to send that report out to the mortgage lender. So, that also goes out to the lender now.

Chairman MURKOWSKI. When did that start?

Mr. O'TOOLE. That started about 2 weeks ago.

Chairman MURKOWSKI. So, this is relatively a new change?

Mr. O'TOOLE. That's right.

Chairman MURKOWSKI. Is there a picture accompanying the appraisal?

Mr. O'TOOLE. The picture that accompanies the appraisal comes to us.

Chairman MURKOWSKI. Is there a value of the land separate from the dwelling?

Mr. O'TOOLE. Yes, Mr. Chairman.

Chairman MURKOWSKI. And, that is on a comparative consideration, too, as well as the dwelling?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. Is the square footage of the dwelling given and the value per square foot?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. On the appraisal form?

Mr. O'TOOLE. On the appraisal form, as well as the square foot——

Chairman MURKOWSKI. How long has that been done?

Mr. O'TOOLE. It's always been that way, as far as I know.

Mr. Chairman, it's a combined HUD/VA appraisal form.

Chairman MURKOWSKI. How would you rate the quality overall of VA appraisals in your own right since obviously you're making changes?

Mr. O'TOOLE. Well, as I said before, I think the quality of the members of the fee panel and the quality of the reports we are receiving is satisfactory. As in anything, things are changing in the appraisal of houses and we're keeping up with that and we want to make whatever administrative changes we can to reflect those changes.

Chairman MURKOWSKI. How do you decide who gets the appraisal in Chicago, westside, where there may be a hundred individuals who have been appraising?

Mr. O'TOOLE. I've got to give Mr. Pedigo a chance to——

Chairman MURKOWSKI. Yes, I figured that.

Mr. O'TOOLE. I'm about ready to pass the gavel, Mr. Chairman.

Chairman MURKOWSKI. That is why I picked Chicago.

Mr. O'TOOLE. Soon as you mentioned Chicago.

Mr. PEDIGO. Mr. Chairman, in Chicago, we have 15 fee appraisers who appraise on the westside of Chicago. When we get a request for an appraisal from a lender we assign it on a rotating basis to the 15 appraisers who appear on the west Chicago roster.

Chairman MURKOWSKI. What is your average—what do they receive for going out and making an appraisal?

Mr. PEDIGO. $100.

Chairman MURKOWSKI. They get $100.

What does the private sector get? Do you have an idea?

Mr. PEDIGO. The private sector varies. It's generally between $100 and $175.

Chairman MURKOWSKI. These same people do the appraising for both?

Mr. PEDIGO. Yes, many of our appraisers also appraise in the private sector.

Chairman MURKOWSKI. What are the professional requirements for these 15 fee appraisers?

Mr. PEDIGO. Well, it's similar to what Mr. O'Toole explained earlier. We require 5 years of appraisal experience. We also require that they have a satisfactory credit record, and that they pass a written test and that they also submit a written appraisal report which we evaluate in their presence.

If they meet all of those qualifications, then they are required to come in for a 1-day training session.

Chairman MURKOWSKI. One-day training session?

Mr. PEDIGO. Well, the initial training session lasts 1 day and it's a personalized training session conducted by the chief appraiser in our office. And, then, twice a year we have training meetings for the appraisers——

Chairman MURKOWSKI. How long has this been going on?

Mr. PEDIGO. I've been in the Chicago office for 2 years, so it's been going on for 2 years and for some years prior to that. I'm not sure——

Chairman MURKOWSKI. Is this a mandatory requirement?

Mr. PEDIGO. Yes; we are directed by our central office to conduct on-going training.

Chairman MURKOWSKI. I am talking about mandatory for your 15 fee appraisers to attend.

Mr. PEDIGO. It is mandatory.

Chairman MURKOWSKI. And, they do attend?

Mr. PEDIGO. They do attend.

We schedule two to three sessions, so that if they have conflicts with one they should be able to attend another one.

Chairman Murkowski. Do they have any—is there a professional requirement that they have an MAI or some other designation?

Mr. Pedigo. No; we look at their experience.

Chairman Murkowski. Do they have these professional titles?

Mr. Pedigo. Many of our appraisers, in fact I would say most of our appraisers, have a designation from one of the appraising societies.

Chairman Murkowski. Professional or otherwise?

Mr. Pedigo. Professional.

Chairman Murkowski. I would appreciate, for the record, a submission of your appraisers and their qualifications. Just as a sample.

[Subsequently, the Veterans' Administration submitted the following information:]

Upon a review of our records there are currently 8 appraisers used by the VA on the Westside of Chicago. The attached chart summarizes their qualifications.

Appraiser's name	Professional designations	Education	Miscellaneous	Clients
Farina, Phillip A.		B.S., M.B.A	Assoc. member—Society of Real Estate Appraisers (SREA). Approved by Ill. Dept. of Reg. and Education to teach appraisal courses.	HUD.
DiDomenico, Vito A		3 yr. college	Assoc. member—SREA. Senior loan off. and appraiser.	Banks.
Tremko, Michael S	SRA (senior residential appraiser) from Soc. of Real Est. Appraisers.	B.S., M.Ed., D. Ed		Attorneys, transfer cos., savings and loans (S&L's) and banks.
Munizzo, Richard M	IFA (indepen. fee appraiser) from Nat'l. Assn. of Indepen. Fee Appraisers.	3 yr. college, 1 yr. law school.	Assoc. member—SREA	HUD, attorneys, major corps., banks, and mort. companies.
Lambert, Jerline	CRA (certified residential appraiser) from Nat'l. Soc. of Real Estate Appraisers.	A.A	Instructor of appraisers courses—Northeastern U. & U. of Chicago.	Attys., banks, and mortgage companies.
Klesken, Joseph J	RM (residential member) of Amer. Inst. of Real Estate Appraisers.	B.S., M.B.A	Assoc. member—American Society of Appraisers (ASA).	Attorneys and banks.
Speziale, Carmen			Assoc. Member—SREA	Attys., banks and S&L's.
Farina, Joseph A		B.S. in Bus. Admin	Instructor of appr. courses.	HUD.

Chairman Murkowski. Do you go out and review a sample of the work of appraisers?

Mr. Pedigo. Yes; we do. We are required by national directive to review 10 percent of the appraisal reports that are submitted to us by the fee appraisers, and this audit requires one of our own staff appraisers to go out and physically inspect the property and the three comparables.

Chairman MURKOWSKI. Have you had an indication of the inventory of foreclosures in your particular area of Chicago?

Mr. PEDIGO. We've had—we've leveled off in Chicago. Right now the foreclosures and acquisitions are at about the same rate that they were 1 year ago.

Chairman MURKOWSKI. How many do you have in foreclosure?

Mr. PEDIGO. We presently have 1,892 properties that we have in title that we have taken back incident to a foreclosure.

Chairman MURKOWSKI. How many do you have pending foreclosure in the process?

Mr. PEDIGO. We have about 1,100 properties that will be coming to us within the next 6 months.

Chairman MURKOWSKI. You have 1,892 past and you have 1,100 more coming in. Is not that an extraordinary ratio of those properties coming in?

Mr. PEDIGO. Well, we have a 6-month redemption period in the State of Illinois. The 1,100 properties are in redemption. The foreclosure process is incomplete and that's consistent with what it always is. We always have a substantial pending number even in good times, we have a certain percentage of properties that are in redemption awaiting title transfer.

Chairman MURKOWSKI. How long has the 1,892 been in your inventory?

Mr. PEDIGO. Well, it varies. We have 133 of those properties that have been in the inventory over 24 months, but about 75 percent have been in the inventory less than 1 year.

Chairman MURKOWSKI. You have 25 percent that have been in the inventory for over 2 years?

Mr. PEDIGO. Well, no; we have 133 out of a total of 1,892 that have been in the inventory over 2 years.

Chairman MURKOWSKI. What do you do with those houses? They are empty, obviously.

Mr. PEDIGO. Most of them that have been in the inventory over 2 years are empty. However, we have a problem in Chicago that is shared in other parts of the country with adverse possession by former veteran borrowers. After a redemption period expires, if the veteran does not voluntarily vacate the property, we institute legal proceedings to have him evicted.

In many instances the veteran, by going to the court and pleading to the judge, can get his stay on that property extended for many months, sometimes even several years, and this is, of course, beyond our control. It's controlled by the courts.

Chairman MURKOWSKI. A portion of that 133 are occupied by veterans who are living and litigating and not paying. Is that right?

Mr. PEDIGO. I really don't know what portion of the 133 are vacant or——

Chairman MURKOWSKI. Is it true that some of these people are not veterans who are living in some of these houses and not paying?

Mr. PEDIGO. That is sometimes the case. The veteran may have sold the property to a nonveteran and it might be the nonveteran who defaulted on the payments.

Chairman Murkowski. Are you satisfied with the progress of litigation that I gather you are constantly pursuing through VA counsel or private counsel?

Mr. Pedigo. We use both VA counsel and also fee attorneys to——

Chairman Murkowski. Mr. O'Toole, is this a problem in the loan program that you have a certain number of your inventory that are out there and that are occupied either by veterans or nonveterans who are litigating and you can not seem to do anything, so the property sits out there?

Mr. O'Toole. Mr. Chairman, it is somewhat of a problem, but the numbers as a whole are not very large. It just takes a lot of staff time to work through these cases and refer them to the proper, whether it's private counsel or the district counsel, and sometimes we have to appear in court. It depends on the jurisdiction.

We probably have somewhere around 14 percent of the inventory that's adversely occupied. So, it's not an overwhelming problem, but it's there. Something we have to contend with.

Chairman Murkowski. I would like for you to supply us with figures relative to the 22,000 foreclosures that we have, and the 11,000 pending as to how many of them are in litigation. And, if possible, I would like to know how many of them represent veterans that occupy vis-a-vis nonveterans because I believe it is a policy of the VA that upon foreclosure and resale they make basically the same financing available to a nonveteran on resale. Is that correct? On a foreclosure in order to move it out of inventory?

Mr. O'Toole. Well, that's right. On the financing that we offer to sell the inventoried houses we will offer that financing to veterans and nonveterans. But, in the order of preference, we give the higher preference to veterans.

[Subsequently, the Veterans' Administration submitted the following information:]

VA held title to 20,395 properties at the end of March 1985, and had eviction actions pending against 218 occupants. We do not maintain statistics on the veteran status of persons who are in adverse possession of VA-owned properties.

Chairman Murkowski. Sure. But what I want to make sure is that, you know, as we look at the program and we identify a situation where there are those that are litigating the foreclosure process that we recognize if indeed many of these people are not veterans that they are nonveterans that are pursuing the process.

I am going to yield to my colleague, Senator Cranston, who I believe has a statement. Senator Cranston is senior minority member of the committee.

I might mention, as I have previously done, Senator Cranston, that we have had a rather revealing statement from the standpoint of our concern, which has been mutual, over the adequacy of the reserve account to meet the historical requirements associated with the loan program and the foreclosures. I think we both have opinions as to the adequacy of the administration's proposal, whether it be 5 percent or 3.8 or 1 or 2.

But, the fact remains, since 1978 transfers from the direct loan revolving fund or supplementals have totaled $1.9 billion into the reserve accounts. That circumstance shows that indeed the program has not been anywhere near self-sufficient and there is obviously something that has got to be done because we are not facing the realities associated with the true and real world that—these reserve accounts are not adequate and we either are going to have to change procedure or look to some other relief.

With that observation, I would invite your statement, and, needless to say, we wish you a good morning.

Senator CRANSTON. Thank you very much. That really doesn't come as a surprise to me because I've been aware of that situation. The main reason there are no funds now is that the direct loan program has been terminated and there's no money coming back into the revolving fund to keep it going. It's plain that we have a problem we've got to confront.

I'm just going to make a very brief statement. I will submit questions in writing. I would like to stay here to do it directly, but I have to be on the floor where we are working on the momentous matter of the budget.

I'm delighted to join in welcoming all the witnesses and guests at this morning's hearing on the VA's Home Loan Guaranty Program.

Chairman MURKOWSKI. Excuse me. Senator, I was asked to go up to the Energy Committee and vote, and I would ask that you conclude your statement and feel free—as long as you want—and if there is any time problem you have to go—but I will be back——

Senator CRANSTON. I know we both have demands on our time.

Chairman MURKOWSKI. Yes, thank you.

Senator CRANSTON. Thank you.

This program, which has served nearly 12 million veterans since its inception after World War II, is an important one, and the operation of it in a manner which will continue to meet the needs of veterans is imperative. I share completely in the concerns of the chairman and many others about the solvency of the loan guaranty revolving fund.

I believe that we need to explore all issues relating to whether there are problems with the VA's home loan guaranty program that are or could be causing a drain on the revolving fund, and we need to identify any such problems that exist and pursue the appropriate actions necessary to resolve them.

If, for example, improvements in the VA's appraisal process could result in a reduced cost to the Federal Government in the case of foreclosures on VA guaranteed loans, those improvements and adjustments should be made as long as they still produce fair valuations. If there are steps that could be taken to reduce the high default and foreclosure experience of the VA, we need to find out what they are and how improvements there might be made that could not only benefit the veteran homeowner but also the Federal Government and all American taxpayers.

I want to take just a moment to express a note of frustration.

I believe we are being severely hampered in our consideration of the issues in this area by the failure of the administration to be completely forthcoming and forthright with respect to various pieces of information. There are numerous reasons why I feel this way.

From the date on which the fiscal year 1986 budget projecting the need for such a large appropriation to the fund was submitted by the President, the administration's primary concern in this area has been to justify its proposal to increase the loan guaranty fee, first to 5 percent, and more recently, to 3.8 percent.

Although the fee increase proposal is not specifically on the agenda for this hearing, the administration's persistent desire to have an increase enacted is part of the environment in which we must examine the loan guaranty program.

The administration has a clear bias and we need to be aware of it.

For example, although the administration has claimed that the fee increase was to protect the fund from shortfalls resulting from defaults, its own data show that its intention has been to accumulate a nearly $2 billion surplus in the loan guaranty fund over the next 5 years.

At the same time, the administration proposed to exacerbate whatever difficulties the fund may encounter by eliminating the VA's long held discretion to transfer amounts from the direct loan revolving fund, where they are not needed, to the loan guaranty revolving fund, where they are.

I see no reason for this proposal except as it plays a part in the administration's overall effort to develop the appearance of a need to increase the fee and raise revenues. Both the administration's and the CBO's projections show that over the next 5 years there will be a total of about $200 million in the direct loan fund, which under a customary provision in the VA's annual appropriation laws would be available to meet any shortfalls in the loan guaranty revolving fund.

This is why I am proposing a permanent statutory authority for interfund transfers and will shortly introduce legislation to provide that authority.

Perhaps the clearest example of the administration's and OMB's bias regarding the loan guaranty program was the administration's ludicrous position taken in February that the imposition of a 5-percent fee would have no effect—no effect—on the number of veterans using their VA home loan entitlements.

As everyone but the administration would acknowledge, the fact is that a 5-percent fee would have prevented hundreds of thousands of veterans, principally Vietnam-era veterans, from using their guaranty entitlement over the next 5 years. Moreover, when challenged at hearings in both Houses, the administration persisted in its ridiculous prediction.

Regrettably, the administration's overriding desire to use a fee increase as a deficit reduction revenue measure has provided reason to view any administration assertions regarding the loan guarantee program with a degree of suspicion.

This is most regrettable. We could be more effective and productive in addressing any problems in the program if the problem were framed honestly, the answers were given openly and correctly to the extent that they are available, and the whole underlying issue of the solvency of the revolving fund were not used illegitimately as a means of deficit reduction.

Having expressed these doubts and these frustrations, I'll close by also expressing my hope that these hearings will be productive and that it will be possible for us, working together and with the help of today's witnesses, to identify and move toward appropriate solutions in a productive and effective fashion.

This concludes my statement.

Senator Mitchell wishes to be here to make a statement but he also has conflicts in his schedule today and could not be. So, I ask unanimous consent that an opening statement by Senator Mitchell be printed at the outset of the hearing following the chairman's, along with Senator Rockefeller's and my own.

Mr. **Principi** [presiding]. Without objection, it will be so ordered.

Mr. O'Toole, I'd like to continue the line of questioning that the chairman pursued with the panel.

A statement furnished to the committee by the mortgage insurers indicated that probably one of the key problems affecting the consumer is poor quality home appraisals and they quoted from the Appraiser Review Journal in their statement, wherein it states:

> Our experience indicates that there is a direct relationship between poor quality loans and poor quality appraisal reports with a recommendation that one immediate goal for the VA as a user of appraisals should be to help impose the development of some reasonable appraisal standards that will identify the effect of financing.

May I please have your comments on that statement.

Mr. **O'Toole**. I would be happy to, Mr. Principi.

We, of course, are concerned about the appraisal of properties as others in the housing financing industry area. I'm not sure I would agree with the author's point of view that a poor appraisal is the main reason for defaults, if that's what the author is saying.

But, the reason that the focus has become concentrated on appraisals is because of the disinflation of property values in the last couple of years. The inflation of property values has not been the savior that it was in years past, so that individuals are not able to sell their houses even for what they paid for them a couple of years ago as a means for curing a defaulted situation.

So, we're concerned about that and we're acting as are others, and we're part of the task force that Fannie Mae put together a few months ago to have an industrywide look at this situation, and that task force is going to come up with some appraisal guidelines on how appraisers should look at different types of financing and how that affects property values.

Mr. **Principi**. With regard to appraisals performed at the time of foreclosure, does the VA systematically review and assess these appraisals to determine whether the appraisals accurately reflect the true market value?

Mr. **O'Toole**. Yes, we do. We review those appraisals and all appraisals are reviewed in our regional office by staff appraisers. We have a system that if the foreclosure appraisal is a certain percentage below what the original appraisal was a staff field review is made and certain procedures are followed to make sure that the new appraisal accurately reflects current market conditions.

Mr. **Principi**. Mr. McReaken, would you please comment on that? Tell me how your office conducts periodic site visits to determine whether the appraisals are accurate, how many appraisals do you review to determine the accuracy? Just an overview please, of how your operations works.

Mr. McREAKEN. We randomly select both appraisers and appraisals in all areas of the area that we cover. We have 90 counties that we review work in.

Selections are made randomly. A staff appraiser will go out to the property, look at the property usually from the street or a visual view. If he can get into the property, then he'll get into the property and verify that what the appraiser reported about the subject is accurate and he will attempt to verify the comparable sale with a visual inspection. In some cases, when possible, to actually verify the sales price and any other terms or conditions of the sale that might not be available in the appraisal report.

Mr. PRINCIPI. Do you have adequate resources to fulfill your responsibilities in that respect? Resources to conduct site visits and review appraisals?

Mr. McREAKEN. In my opinion we do. We have market guide services that we subscribe to and assist in the collection of data for those services. We use those services to verify the comparable sales actually did take place. We check with the board of realtors for the multiple listing services. In some cases to verify sales data. And, we check the brokers in the field.

Mr. PRINCIPI. Have any appraisers ever been suspended because of inadequate appraisals?

Mr. McREAKEN. Yes, sir.

Mr. PRINCIPI. Is that true on a national basis, Mr. O'Toole?

Mr. O'TOOLE. Oh, that's right. In fact we just completed a review of our office in Florida. In that office over 100 appraisers have been suspended for poor performance.

Mr. PRINCIPI. As a general matter, is it true that there are no uniform regulations governing appraisal methodology, standards, or qualifications with regard to training and continuing education?

Mr. O'TOOLE. Well, essentially what the guidelines are is that——

Mr. PRINCIPI. No; I'm not asking about guidelines. Are there uniform regulations governing the appraisal methodology and the appraisal qualifications? That is, if you did not have a certain level of education or training or tenure, you cannot be on that list.

Mr. O'TOOLE. There are uniform qualifications to be on our appraisal panel.

Mr. PRINCIPI. And, to what do those qualifications relate?

Mr. O'TOOLE. Well, as I indicated earlier, the appraiser has to meet certain experience requirements, has to be functioning as an appraiser for a certain period of time, submits written reports, submits information about other clients that they've worked with, has to take a written test in our office.

Chairman MURKOWSKI [presiding]. Thank you. A couple of other questions.

Has there been any thought given to having the lender make the appraisal?

Mr. O'TOOLE. Well, Mr. Chairman, the mortgage lender can always order their own appraisal after we have done ours.

Chairman MURKOWSKI. But there is no real reason why they should?

Mr. O'TOOLE. Well, they might want to protect their own interests if they feel that is of some concern.

Chairman MURKOWSKI. Yes; but what is their risk?

Mr. O'TOOLE. Well, it is fairly high if we are going to pay the claim on 10 to 12 percent of the properties that go to foreclosure. We do not want to acquire those. So there is some risk involved. It is not a no risk process.

Chairman MURKOWSKI. We can get into the risk a little later when you finish. My question is again why do you not have the lender select and make the appraisal and just simply send a copy to you?

Mr. O'TOOLE. Because the purpose of the appraisal is to protect the Government's interest.

Chairman MURKOWSKI. Well, I know, but you are giving a guarantee to the lender to protect his interest which certainly reduces his exposure.

Mr. O'TOOLE. It reduces the lender's exposure. But the purpose of the appraisal is for the VA to determine what our exposure is going to be.

Chairman MURKOWSKI. Well, I know. But in reality, you get that from a competent lender doing the appraisal for you.

Mr. O'TOOLE. My strong feeling is that it is important for us to maintain the integrity of assigning the appraisal.

Chairman MURKOWSKI. Why?

Mr. O'TOOLE. Because it eliminates the possibility of collusion between the lender and the appraiser.

Chairman MURKOWSKI. Well, that exists in any relationship.

Mr. O'TOOLE. Yes, it does.

Chairman MURKOWSKI. Whether it be a conventional, or a FHA program, or what have you.

But is not the VA one of the few programs that has its own appraisal procedure?

Mr. O'TOOLE. I think that other programs have appraisal procedures, but they are not all the same as ours.

Chairman MURKOWSKI. Well, let me ask you this.

Is the VA the only program that requires the selection of the appraiser by the VA?

Mr. O'TOOLE. In some parts of the FHA program, the lender is allowed to make the assignment of the appraiser. But I would submit, Mr. Chairman, that fortunately we have had few incidences of collusion and fraud in our program. And I would not want to institute a program that would encourage that.

Chairman MURKOWSKI. Well, I know. But we already have acknowledged that you have got some problems in your program or the inspector general would not be down there, and the Director would not have directed the inspector general to be down there. And you are indicating procedural changes.

But I am saying that let us assume that the VA said, okay, we want the lender to do the appraisal process, and here are the requirements that the appraiser has to have. They have to meet a professional standard established within the industry, whether it be a MAI or some other uniform standard.

Now what is the risk to the VA?

Mr. O'Toole. Well, the risk to the VA is that the mortgage lender, the firm that is going to make the loan, that is going to be the beneficiary of that loan being made, and the beneficiary of the guarantee would be assigning the appraiser, reviewing the appraisal, and determining the Government's liability.

Chairman Murkowski. What is done under the FHA Home Loan Program?

Mr. O'Toole. The FHA Home Loan Program is a little bit different in that it is an insurance program, and there are reserves that take care of losses.

Chairman Murkowski. Well, sure. But by the same token, who makes the appraisal, who orders the appraisal?

Mr. O'Toole. In the FHA program?

Chairman Murkowski. Yes.

Mr. O'Toole. In some instances, the appraiser is selected by the lender from a list that is given to them by the FHA.

Chairman Murkowski. And have they had an extraordinary experience with collusion?

Mr. O'Toole. Well, it is a fairly new program, so I really do not know.

Chairman Murkowski. Well, the FHA program has been around for awhile.

Mr. O'Toole. I realize that, Mr. Chairman. They have been allowing the assignment of the appraisers only for about a year.

Chairman Murkowski. Well, I am not satisfied that I have gotten really an answer that has been reflected on an evaluation of whether it would be easier and more responsive to leave that obligation to the lender.

How much time is spent individually and collectively by VA officials on this process of working with appraisers that would be eliminated if the appraising process were done by the lender; in other words, off an approved list like FHA?

Mr. O'Toole. It takes us 15 days to process an appraisal from the time that it is ordered to the time of the evaluation.

Chairman Murkowski. How many people are involved in this process in the VA?

Mr. O'Toole. About 350 nationwide.

Chairman Murkowski. So if you eliminated it, theoretically there would be 350 people doing something else?

Mr. O'Toole. Well, I would think that if you did eliminate it, you would also have to increase the amount of auditing that you did behind the appraiser. I am sure that even if they were not doing what they are doing now, they would be doing some kind of an audit process.

Chairman Murkowski. What kind of an audit process?

Mr. O'Toole. Once again, if the appraiser is determining the amount of the Government's obligation, I would think that——

Chairman Murkowski. Well, he is coming up with a figure, and that is his best professional evaluation and judgment, which is what any appraiser is going to do.

Mr. O'Toole. Mr. Chairman, I would submit that there would have to be some periodic audit of that appraiser's work, if he is obligating the Government.

Chairman MURKOWSKI. I am sure that there is that process that takes place within insured financial institutions where those loans are audited two times out of every 3 years as a matter of course within the function of a Federal insured agency. So you know, you are not waiving the audit function necessarily.

So there are 350 employees in the VA that somehow are involved in this process of handling this?

Mr. O'TOOLE. Approximately.

Chairman MURKOWSKI. That is, I guess, $10 or $11 million annually, I am told for the record. OK, let us go back to where we were. I interrupted you. And we were down to the question of the appraiser coming in with the appraisal on the property, and you said that the property was about $70,000. And the appraisal has been ordered by the VA office, the field office, or some other thing.

Mr. O'TOOLE. It has been ordered by the mortgage lender through our office.

Chairman MURKOWSKI. Through the VA. The mortgage lender phones up the VA. The VA then does the appraisal, reviews the appraisal, has an individual.

Mr. O'TOOLE. The fee appraiser does the appraisal, submits it to the VA for review, and then we issue a certificate of reasonable value.

Chairman MURKOWSKI. Over to the lender?

Mr. O'TOOLE. Over to the lender. At the same time, the lender has obtained the verifications that are necessary. The verification of employment, and then the credit report, and the verification of deposit, whatever is necessary to put the credit package together.

Chairman MURKOWSKI. And we are at that point now?

Mr. O'TOOLE. We are at that point.

Chairman MURKOWSKI. We have $70,000 and there is an appraisal on the place.

What kind of appraisal do you have to have to warrant a $70,000 loan?

Mr. O'TOOLE. You would have to have a $70,000 appraisal. The property would have to be worth the same as the loan amount.

Chairman MURKOWSKI. Equal to, not above, no percentage, just equal to?

Mr. O'TOOLE. Equal to.

Chairman MURKOWSKI. Does the appraiser know the sales price of the home?

Mr. O'TOOLE. I would think in most cases. It is not a requirement, but I would think that a prudent real estate agent would make sure that the appraiser knew the amount.

Chairman MURKOWSKI. How does the appraiser find that out?

Mr. O'TOOLE. Well, the lender probably tells him.

Chairman MURKOWSKI. I did not think that the lender had any contact with the appraiser. I thought that the appraiser was ordered by the VA, and the VA took him off the list. That he did the appraisal, and the appraisal came back to the VA, and then the VA forwarded it on to the financial institutions.

Mr. O'TOOLE. The VA gives the mortgage lender the name of the appraiser, and the contact is made from the lender to the appraiser.

Chairman MURKOWSKI. My question is how would the appraiser have occasion to find out how much the home was selling for?

Mr. O'TOOLE. Well, in most cases, they would have to call the real estate agent to get access to the property, or the owner at the time would indicate that we are looking for x number of dollars.

Chairman MURKOWSKI. So we have got a $70,000 appraisal.

What happens now at the financial institution?

Mr. O'TOOLE. Then you would have a complete credit package. You would have all of the necessary verifications and credit report.

Chairman MURKOWSKI. Now who does the verification and credit report?

Mr. O'TOOLE. That is all ordered by the lender.

Chairman MURKOWSKI. By the lender?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. Ordered by the lender?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. And what is done with that?

Mr. O'TOOLE. The lender, if they have the authority to close on an automatic basis, would review that package and commit on behalf of the VA and say that it is an approved loan, and then go to closing.

Chairman MURKOWSKI. How do you get to be one of these approved lenders?

Mr. O'TOOLE. All supervised lenders, those that are supervised by another Federal institution, are automatically approved for that.

Chairman MURKOWSKI. What do you mean?

Mr. O'TOOLE. Every bank, savings and loan, federally chartered savings and loan has that authority.

Chairman MURKOWSKI. Every federally insured agency then has the authority, that would be a rule of thumb?

Mr. O'TOOLE. Right. And mortgage bankers that meet qualifications that we have established.

Chairman MURKOWSKI. You could use the rule of thumb in the sense of an insured lender. Now they can do the verification and credit.

Do you have a standard requirement that that has to meet?

Mr. O'TOOLE. We publish to the lender underwriting requirements.

Chairman MURKOWSKI. Have those been changed recently?

Mr. O'TOOLE. They change all of the time. We have a fairly large change that we are working on right now. But they are changed to reflect what is happening in the economy and other changes in underwriting.

Chairman MURKOWSKI. Give me an idea of your underwriting, the underwriting requirements on the verification of employment.

Mr. O'TOOLE. Maybe I will ask one of the field people to do that, Mr. Chairman, if that is all right.

Mr. PEDIGO. Would you please repeat that question.

Chairman MURKOWSKI. Verification of employment, your underwriting standards, that you direct to the approved financial agency that is federally insured that is going to go ahead and on its own make a decision on the adequacy of the employment.

Mr. PEDIGO. The basic requirement for the verification of employment is that we have coverage for at least 2 years.

Chairman MURKOWSKI. What does that mean?

Mr. PEDIGO. In other words, that the veteran has been on his present job for at least 2 years. That is the only verification of employment that we will require of the lender. However, if the veteran has only been employed with that particular employer for 1 year, we would ask the lender to provide us an employment verification from his previous employer or employers, so that we would have 2 years of coverage for that particular veteran.

We review these employment verifications to make sure that we have been provided with information concerning the veteran's annual salary or his hourly rate and any overtime earnings.

Chairman MURKOWSKI. Now I am confused. You say that you review. And I am told that the approved lending agency can approve as long as they meet your underwriting qualifications.

Mr. PEDIGO. OK. If it is a lender who is authorized to close the loan on an automatic basis, then the lender would perform the same review that we would at the VA office.

Chairman MURKOWSKI. The veteran must have a job or a 2 year history of some nature.

What about verification of credit?

Mr. PEDIGO. We require a credit report from the commercial credit reporting agency that will provide once again information for at least the previous 2 years.

Chairman MURKOWSKI. Suppose the information showed poor credit?

Mr. PEDIGO. We would review each case and make a judgment.

Chairman MURKOWSKI. But again, you are saying that you are reviewing.

Mr. PEDIGO. Do you want me to talk about the automatic program?

Chairman MURKOWSKI. Well, who is doing what in your underwriting?

Mr. PEDIGO. OK. We have about 30-percent automatic loans and 70-percent prior approval loans in Chicago.

Chairman MURKOWSKI. Now your prior approval is what we are talking about.

Mr. PEDIGO. The prior approval is where the VA actually reviews the credit documentation at the VA office, and the decision is made at the VA office as to whether or not the veteran qualifies.

Chairman MURKOWSKI. That is what you call prior approval?

Mr. PEDIGO. That is what we call prior approval.

Chairman MURKOWSKI. Is there a reason that this cannot be done in the private sector by all of the financial institutions that qualify, why is it necessary that the VA do a duplicate function that is available in the private sector?

Mr. O'TOOLE. Well, first, Mr. Chairman, the nationwide figure is about 50–50. Fifty percent of the loans are done by the lenders, and 50 percent are done by us. First of all, not all lenders meet——

Chairman MURKOWSKI. Well, you said qualifications. All federally insured financial institutions. You cannot find a corner where there is not one.

Mr. O'TOOLE. But over 70 percent of our business is done by mortgage bankers. And there are some mortgage bankers who do not meet the qualifications to be an automatic lender.

Chairman **Murkowski**. Have you ever looked at your inventory and found out where your greatest problems are coming from, what segment of the industy, are they coming from the federally insured lenders, or your mortgage lenders who do or do not meet all of the requirements of the VA itself; in other words, where are your underwriting losses occurring?

Mr. **O'Toole**. The default rate is higher on those loans that have been submitted to us for approval than those loans that are approved by lenders.

Chairman **Murkowski**. Would you provide for the record some specific percentages, do you have that information available?

Mr. **O'Toole**. Sure.

[Subsequently, the Veterans' Administration submitted the following information:]

Loans approved on the automatic basis represent the best credit risks and are those veterans who meet all of the VA's credit standards without difficulty. The following chart provides data on the foreclosures of home loans originated fiscal years 1970 through 1984:

Total:	
Loans	4,169,261
Foreclosures	187,593
Percent	4.50
Prior Approval:	
Loans	3,537,804
Foreclosures	174,217
Percent	4.92
Automatics:	
Loans	631,457
Foreclosures	13,376
Percent	2.12
Supervised:	
Loans	349,745
Foreclosures	7,659
Percent	2.19
Nonsupervised:	
Loans	281,712
Foreclosures	5,717
Percent	2.03

Automatic lenders are aware that if they develop a record of closing loans which do not meet VA's credit standards, their automatic authority may be terminated. Most lenders want to minimize the risk of losing their automatic authority and only close "premium" loans on the automatic basis. Because they fall into a higher risk category, it is to be expected that loans approved under the prior approval basis would suffer a higher rate of default than those processed under the automatic procedure.

Chairman **Murkowski**. Can you give us an explanation of why the loss rate or default rate should be higher among those approved by the Veterans' Administration?

Mr. **O'Toole**. Yes. Mr. Chairman, what happens is that the automatic lender is most likely more reluctant to take the chance on approving the loan. If a loan is all outside of what they consider the parameters for an approval, they are going to submit that loan to our office for review.

At the same time, they will probably do additional work to support that loan. And when those loans are submitted to us for review, a great number of them are turned down, of course. But the loans that we get in the office from the automatic lenders tend to be the toughest loans to underwrite, and consequently end up with a little bit higher default rate.

Chairman MURKOWSKI. Do you have the same underwriting procedure in the VA that you dictate to your lenders?

Mr. O'TOOLE. Yes.

Chairman MURKOWSKI. Well then, why should the rate of default be higher on yours if you practice the same underwriting requirements?

Mr. O'TOOLE. As you know, Mr. Chairman, underwriting is a judgment. If the lender chooses not to approve a loan and submits it to us.

Chairman MURKOWSKI. Whether it qualifies within the guideline or it does not.

Mr. O'TOOLE. Well, there is an awful lot of judgment in loan underwriting.

Chairman MURKOWSKI. Well, it depends on how general you are in making your guidelines. You know, you can type them up and see whether it falls in the category or it does not.

How long will it take you to provide us with figures relative to underwriting experience of the various groups that are underwriting the VA loans?

Mr. O'TOOLE. We can have that within the week, Mr. Chairman.

Chairman MURKOWSKI. And I assume that the categories will be the VA, the federally insured financial institutions, and then the mortgage banker groups.

Mr. O'TOOLE. Mr. Chairman, as far as I know, we do not break it down. We break it down by automatic and prior approvals. And that is the extent of the breakdown.

Chairman MURKOWSKI. And we would like to have with those percentage figures roughly the volumes. In other words, you are saying that you do 30 percent.

There is a debate on the floor involving Social Security and some other things. There is going to be a vote in a few minutes, and I am going to have to go and make a statement prior to the vote. So Mr. Principi will continue to conduct the hearing. But I am going to try to finish the questioning at least to the point of verification of credit.

In some cases, it meets an underwriting standard as dictated by the VA, and a decision is then made to go ahead and grant the credit by the approved financial institution.

Mr. O'TOOLE. That is right.

Chairman MURKOWSKI. Now I see an inconsistency here where the Government allows the verification of employment and verification of credit decisions being made independently by the underwriter which obviously is a reflection on the Government's interest, and has as much exposure to collusion as does the appraiser. So I fail to see the consistency of where the Government on one hand allows verification of employment and verification of credit, both of which are significant judgments in the financial analysis, and yet refuses to allow the approved lender to make the dictate on the appraisal.

And I assume that both verification of employment and verification of credit are made independently, although copies are sent to the VA, so that you are in an oversight process.

Mr. O'Toole. That is right. It would appear to be an inconsistency. But first of all, I think that it is important to note that we review 100 percent of all loans that are processed under the automatic basis. So all loans that are approved by the financial institutions are reviewed by our office after the loan is made.

Chairman Murkowski. Yes; and by the same token, you say that they send the tough ones down to you, and you have to make the value judgment.

Mr. O'Toole. Sure.

Chairman Murkowski. My point is, I think that, if it is good for verification of employment and verification of credit, why is it not good for the appraisal?

Mr. O'Toole. Well, we have the financial institutions that you mentioned that are under Federal scrutiny by other agencies. We have the mortgage lenders who are approved because they have certain net worth requirements and experience requirements as opposed to 20,000 fee appraisers who do not meet those kind of requirements and are not reviewed by other institutions.

[Subsequently, the Veterans' Administration submitted the following information:]

There are approximately 7,000 active fee appraisers currently used by the VA.

Chairman Murkowski. Well, the VA could come up with whatever requirements that the VA wanted to set as to what standards those agencies have to meet in order to be able to provide the services of a VA mortgage. Obviously, you are not going to let every Tom, Dick, and Harry go out and act as an agent for the VA, and they have to and should meet whatever reasonable requirements are dictated by the VA.

I am sure that it is not your posture to suggest that we open the system to those whose qualifications are questionable just so that they can participate in the business. That certainly does not make sense. And that is why I think that it will be very interesting to see where your losses are occurring, and where your underwriting problems are occurring.

Mr. O'Toole. Well, of course, the mortgage lender, because of the fact that it is a guaranteed program, that the lender is going to share whatever losses take place from the foreclosure; the lender has a good deal of risk also. The appraisers do not have that same risk.

Chairman Murkowski. We have got the verification of employment and verification of credit. So the loan is made, right?

Mr. O'Toole. Yes, Mr. Chairman.

Chairman Murkowski. And the documentation and so forth. Now on this $70,000 loan, 2 years later, the balance on it is $68,000.

Mr. O'Toole. It is certainly not quite that low.

Chairman Murkowski. It is not quite that low, that is right.

Mr. O'Toole. More like $69,500.

Chairman Murkowski. All right, $69,500; 2 years later, 6 months have gone by and no payments. And the mortgage financing agency notifies you, and you start a process. Now the lender has advanced the $70,000.

Mr. O'Toole. The loan is made.

Chairman MURKOWSKI. Yes; there is no Government money out there?

Mr. O'TOOLE. That is correct.

Chairman MURKOWSKI. There is a Government guarantee?

Mr. O'TOOLE. That is right.

Chairman MURKOWSKI. And the maximum guarantee is——

Mr. O'TOOLE. $27,500.

Chairman MURKOWSKI. $27,500. So in this case, the lender is out $1,500 plus his fees or whatever, $500, right. So again, the Government only has to come up with a very small portion assuming that he can resell it. The process there is what I want to walk through with you, and then I want to walk through those where we have a problem on reselling and how this $27,500 is affected by actions taken by the VA, and the option of both the mortgage lender and the VA as far as the question of who buys what back.

Mr. O'TOOLE. OK.

Chairman MURKOWSKI. Excuse me, I am going to leave the chair to Mr. Principi. I think that what he intends to do is excuse your group and perhaps call the other witnesses, so that we can expedite the process, and then call you back.

Mr. O'TOOLE. We are not going to walk together through this process?

Chairman MURKOWSKI. Well, gee, I would hate to miss it.

Mr. PRINCIPI [presiding]. One moment please, I do have just a couple of questions which I want to ask before we call the next panel.

With regard to some of this credit underwriting, in the past few years, we have seen rather innovative forms of creative financing as the interest rates have gone through the roof.

Let us just suppose for the moment that the builder buys down the loan from 15 percent to 12 percent or 11 percent for the first 3 or 4 years of the loan. According to your credit underwriting guidelines or standards, when this veteran comes in to qualify for the loan, is it based upon the buydown of 11 percent or 10 percent, or is it based upon the 15 percent that this veteran is going to be saddled with in 3 or 4 years?

Mr. O'TOOLE. Well, first of all, there are not too many instances where you would see a buydown difference between 15 percent and 10 percent. The normal buydown is a 3-2-1 buydown where the rate is 3 percent below the coupon rate the first year, and goes up a percentage point each year until the third year where it would be at the initial prevailing rate.

We would generally underwrite the loan based on the payment at the time the loan is made, but consider the fact that there is going to be an increase in payment over 3 years. There is going to be a gradual increase in payment.

So we would look at the applicant based on that knowledge, of course, that there is going to be an increase in payment. When we know what the payment increase is going to be and we would consider that in underwriting.

Mr. PRINCIPI. My question is rather specific.

At the VA, does the veteran have to qualify based upon a payment, a monthly payment of principal and interest that is the true value of the interest rate, 15 percent or 14 percent, or is it the 12 percent at the time that the individual acquired the home?

When you look at some of the ads in the newspaper, in the real estate section, it is very difficult to tell precisely what the true interest rate is. You see a lot of veterans out there who are being led down the primrose path based on some of the creative financing only to find out the true interest rate 3 years later and no substantial increase in their income and no equity in that house. As a matter of fact the house was probably overpriced to take into consideration the buydown so the market value is really not true, and as a result the veteran is in the position of having to go to foreclosure.

Do you direct the mortgage bankers, or whoever will write the loan to take into consideration the increases in future payments?

Mr. O'TOOLE. We underwrite the loan based on the initial monthly payment, but we certainly do not ignore the fact that there is going to be a payment increase.

Mr. PRINCIPI. What do you mean that you do not ignore future increases in payments, you do not underwrite the loan based upon it, but you do not ignore the future increases in payments either?

Mr. O'TOOLE. That is right. We look at a loan like that, and we would look for more income even during the initial periods of the loan than we would otherwise. If we know that the payment is going to continue over a period of 30 years at a fixed amount, that is one way to look at the loan.

And I do not accept your premise that there have been a lot of foreclosures as a result of those kinds of loans, because that certainly has not been our experience. And we would know what the true facts of that interest rate are, and we would not rely on newspaper advertisements or anything of that sort.

But we know what the payment increase is going to be, and we consider it in the loan. We look at the potential of that particular individual, the type of employment that they may be in, and we would underwrite on that basis.

Mr. PRINCIPI. With regard to lenders with automatic approval authority, do you direct the underwriters to take future increases in payment into consideration?

Mr. O'TOOLE. Yes, we do.

Mr. PRINCIPI. Could you furnish a copy of those regulations to the committee?

Mr. O'TOOLE. Sure.

[Subsequently, the Veterans' Administration submitted the following information:]

Credit underwriting for loans involving acceptable temporary interest rate buydowns are based on the first year's payment amount, provided there can be a reasonable expectation that the veteran's income will increase to cover the scheduled yearly increases in loan payment. Information on buydowns is contained in DVB Circular 26-82-13 and Change 1 to that Circular, copies of which are attached.

Department of Veterans Benefits
Veterans Administration
Washington, D.C. 20420

DVB Circular 26-82-13
Change 1
June 10, 1982

ESCROWS ESTABLISHED BY THE SELLER TO TEMPORARILY REDUCE THE BUYER'S MONTHLY MORTGAGE PAYMENT

1. Numerous inquiries have been received concerning the acceptability of buydown plans which do not meet the criteria outlined in DVB Circular 26-82-13, paragraph 1a. Other plans will be accepted, and the benefit of the plan to the veteran will be considered in credit underwriting.

2. Therefore, DVB Circular 26-82-13 is changed as follows:

Page 1

Paragraph 2: Delete and insert the following

"2. Credit underwriting for loans involving temporary interest rate buydowns which meet the criteria in paragraph 1a above will be based on the first year's payment amount, provided nothing would preclude a reasonable expectation that the veteran's income will increase to cover the scheduled yearly increases in loan payments. Buydown cases in which both the veteran's present income is marginal and some doubt exists as to whether his or her income will keep pace with the payment increase schedule will not be approved.

3. Buydown plans not meeting the criteria in paragraph 1a above may also be accepted. However, in credit underwriting loans with plans not in conformity with these criteria, the loan analysis will be based on the full mortgage payment, but the existence of the buydown arrangement will be treated as an additional factor for consideration."

Existing paragraphs 3 and 4: Redesignate as paragraphs "4" and "5".

3. Stations will reproduce paragraphs 1 and 2 of this change, substituting local release numbers for the circular references, for distribution to all program participants. Local releases should only reference redesignation of the existing paragraph 3 since the existing paragraph 4 was not reproduced in the previous release. Copies of these releases need not be submitted to Central Office.

Dorothy L. Starbuck
DOROTHY L. STARBUCK
Chief Benefits Director

Distribution: CO: RPC 2021 plus 25 additional copies to (26A5)
FD FLD: RPC 2021

Department of Veterans Benefits
Veterans Administration
Washington, D.C. 20420

DVB Circular 26-82-13
(Confirming Teletype Trans.)
April 16, 1982

ESCROWS ESTABLISHED BY THE SELLER TO TEMPORARILY REDUCE THE BUYER'S MONTHLY MORTGAGE PAYMENT

1. The Administrator is required by statute to establish the reasonable value of homes used as security on VA guaranteed loans, and the maximum VA loan may not exceed this reasonable value. Current market conditions have shown a need for builder/sellers to temporarily reduce the loan payments for a purchaser during the initial years of the mortgage. VA, in responding to these market forces and for consistency with buydown plans currently acceptable to secondary market investors, has adopted the following policies. Effective immediately certain loans containing temporary interest rate buydowns will be acceptable to the VA for guarantee, if otherwise eligible. VA will not reduce reasonable values in transactions involving temporary interest rate buydowns under the following criteria:

a. The assistance payments will run for a minimum of 3 years and a maximum of 5 years. Scheduled reductions in the assistance payments must occur annually on the anniversary date of the first mortgage payment. The annual payment increases must be in equal or approximately equal amounts. Alternately, when the subsidy is calculated by setting the veteran's initial payments to a lower interest rate, the reductions in the assistance payments may be accomplished through equal annual increases in that interest rate.

b. The payments will be made directly to the mortgagee or servicer by the escrow agent, except where FNMA (Federal National Mortgage Association) is the holder, in which case FNMA may take custody of the funds. In all other cases, the funds must be escrowed with an independent third party escrow agent safely beyond the reach of prospective creditors of the builder/seller, lender, and the borrower. A copy of the escrow agreement must accompany the loan submission.

c. The escrowed funds may not revert to the builder/seller under any circumstances. If the property is sold subject to or on an assumption of the loan, the escrow must continue to pay out on behalf of the new owner.

d. The borrower's only interest in the funds is to have them applied to payments due under the note. The funds may not be used to pay past due monthly loan payments. In the event of foreclosure or prepayment of the loan in full, the funds must be credited against the veteran's indebtedness.

2. Credit underwriting for loans involving temporary interest rate buydowns which meet the above criteria will be based on the first year's payment amount, provided nothing would preclude a reasonable expectation that the veteran's income will increase to cover the scheduled yearly increases in loan payments. Buydown cases in which both the veteran's present income is marginal and some doubt exists as to whether his or her income will keep pace with the payment increase schedule will not be approved.

3. A temporary interest rate buydown may not be used if the veteran is acquiring the home with a VA guaranteed Graduated Payment Mortgage.

4. Stations will reproduce paragraphs 1 through 3 for distribution to all program participants as soon as possible. Copies of these releases need not be submitted to Central Office.

DOROTHY L. STARBUCK
Chief Benefits Director

Distribution: CO: RPC 2021 plus 25 additional copies to (26A5)
FD FLD: RPC 2021

Mr. **Principi**. Upon learning of new defaults, what steps are being taken by the VA to contact delinquent veterans in an effort to assist them in bringing the delinquencies current?

Mr. O'**Toole**. Well, our regulations require that the mortgage holder is the prime servicer of delinquent accounts. It is the lender's responsibility to make the contacts, and to determine the reason for the default, and to cure that default if at all possible.

When we are notified that the loan is in default, as required by the regulations, we make initial contact by a computer generated letter that goes out to the veteran telling the veteran to contact the lender. If that does not work, we make telephone contact. We use some personal servicing and we go out and try to contact the veteran.

In every case where there is a determination that foreclosure is pending, we make personal contact.

Mr. **Principi**. In view of the fact that you buy back properties in 90 percent of the cases from the lender, and you have to make the lender whole when you buy back the property, you pay back all of the arrears, principal and interest, would it not be in the VA's best interest to be notified sooner that a default has occurred, so that you can begin servicing that loan and trying to work out an arrangement with the veteran to bring his loan current, or even to commence foreclosure proceedings where it is determined that there is no reasonable hope that the veteran would be able to bring it current, thereby minimizing your losses?

Mr. O'**Toole**. Well, Mr. Principi, I am not sure that that would minimize the losses.

Mr. **Principi**. Excuse me for one moment.

We will conclude with this question regarding the time when the VA is notified of a default in order to minimize certain losses. Your views on that possibility.

Mr. O'**Toole**. Well, first of all, there is nothing that precludes the lender from submitting a notice of default after the first payment becomes due. Keeping in mind that the holder's responsibility is to service that loan. We don't get involved in it until it's become a more serious default. Our supplemental servicing is to assist the lender and their main job is servicing that loan.

You should also know that over 80 percent of all loans that are reported in default are cured. So, we'd be getting a large number of reported defaults particularly in the early months—we'd be getting a large number of loans that are reported to be in default that are going to be cured. And, there's a manpower problem so I——

I'm not sure that is going to be the answer to reducing the number of loans that go into foreclosure.

Mr. **Principi**. Or the savings?

Mr. O'**Toole**. I don't think it's substantial. I really don't simply because we'd have to—you may have some savings in the revolving fund, perhaps. I don't think it's going to be very much. But, you'd have more people to process the additional default notices that you're going to generate and you're going to generate a lot more because an awful lot of loans are one payment past due.

Mr. **Principi**. Minority chief counsel has one question, Jon.

Mr. **Steinberg**. Thank you, Tony.

Actually, I have one brief question for Mr. O'Toole and one for Mr. Ivers.

Mr. O'Toole, in view of the experience thus far under the requirement established by Public Law 98-369 that the VA sell at least 25 percent of the properties it acquires for cash rather than the use of vendee loans, is it your personal opinion that the requirement helps or hurts the solvency of the loan guaranty revolving fund?

Mr. O'TOOLE. Well, I think it's been good and that it's identified some properties that are probably more advantageous for us to sell for cash. What's happening is we're selling the poorer quality houses for cash. We weren't sure how it was going to work out, whether it was going to be the high quality properties where outside financing would be involved or whether it was going to be the low end. In most regional offices it is the lower end. And, that requirement has really helped us to identify those to reduce the number that we were holding for long periods of time, and it certainly has provided an infusion into the revolving fund.

Mr. STEINBERG. You're not saying whether in the long run——

Mr. O'TOOLE. Well, in the long run it's hard to tell. It's really hard to tell in the long run.

The immediate impact is we've been able to clean up some of the old stuff.

Mr. STEINBERG. And, your statement, I believe, makes clear that you anticipate no difficulty in meeting the 25-percent requirement in terms of what you're able to do with the remainder of fiscal 1985?

Mr. O'TOOLE. That's right.

Mr. STEINBERG. Mr. Ivers, I want to—on a totally different subject—ask you about the collection of data on racial and ethnic characteristics of veteran home buyers.

In February of this year it is our understanding that the Office of Management and Budget, by taking the position that it would not approve a VA form, effectively prohibited the VA from continuing to collect data on the racial and ethnic characteristics of veterans who apply for benefits through the Home Loan Guaranty Program. As we understand, OMB took the position that the information requested on the application form was not necessary for the proper performance of the agency's responsibilities and that this information could be obtained elsewhere.

In general terms—and more completely for the record, if you would—could you state the nature of the information collected and the manner in which it is collected? That is, what questions are asked and is it clear to the veteran that supplying this information is voluntary?

Mr. IVERS. Well, the answer is that it is clearly—it's clear on the form itself and it's made clear to the veteran that supplying that information is voluntary. Supplying the information consists of checking, I believe, two boxes on the form.

I had a meeting scheduled this afternoon, at 3 o'clock, with the general counsel of OMB at which time we hope to arrive at a final disposition of that matter. We had not yet—he and I have been in discussion for some time now.

Mr. **Steinberg**. Are there any sources from which it would be possible to obtain the data?

Mr. **Ivers**. Not in a majority of the cases without the creation of another form.

Mr. **Steinberg**. For what purpose does the VA use the data it collects on that form?

Mr. **Ivers**. That data is compiled and retained and used in response to inquiries from committees on the Hill or from other agencies or in use of litigation. We have three cases in litigation for which that information has been pretty specific.

Mr. **Steinberg**. Fair housing litigation?

Mr. **Ivers**. Yes.

Mr. **Steinberg**. In your response for the record on this, would you submit a copy of the form?

Mr. **Ivers**. Certainly.

[Subsequently, the Veterans' Administration submitted the following information:]

Attached is a copy of the Application for VA or FmHA Home Loan Guaranty or for HUD/FHA Insured Mortgage, in addition to a copy of the Credit Statement of Prospective Purchaser and Contract of Sale.

Form Approved
OMB No. 2900-0144

INSTRUCTIONS FOR PREPARATION OF APPLICATION FOR VA OR FmHA HOME LOAN GUARANTY OR FOR HUD/FHA INSURED MORTGAGE

This form is to be used by lenders when applying for prior approval of a VA-guaranteed loan for the purchase, construction or simultaneous purchase and improvement of a home or farm residence under Section 1810(a)(1), (2) or (3), Title 38 U.S.C., for the purchase of a one-family unit in a condominium project or development under Section 1810(a)(6), Title 38 U.S.C., for refinancing loans under Section 1810(a)(5), Title 38 U.S.C. or for home improvement or repair or energy conservation improvement loans not involving the purchase of a residence as authorized under Section 1810(a)(4) or (7). This form may also be used for processing the credit of borrowers under any HUD/FHA 1-to-4-family program or for converting an outstanding commitment to a firm commitment in the name of an approved borrower. When applicable, this form may be submitted to USDA-FmHA for the evaluation of a borrower for a FmHA-guaranteed loan.

In every case the lender MUST SUBMIT AS SUPPORTING EXHIBITS TO THIS APPLICATION: (1) Original credit report on borrower(s); (2) Original verification of employment of the applicant *(and spouse or co-borrower, if applicable). (This verification must reflect the amount of income from regular employment. Overtime, commissions, bonuses, etc., should be shown separately. The probability of continued employment must also be shown. Form VA 26-8497/FmHA-410-5/HUD-6233/92004-g may be used to verify both present and past employment.)*; (3) Original verification of deposit *(Form VA 26-8497a/HUD-92004-f may be used to verify deposit of cash assets from any source.)*; (4) Copy of executed sales or construction contract; (5) If new construction, copy of VA Form 26-1843a, Master Certificate of Reasonable Value *(if VA loan)*, if the subject property is evidenced thereon; (6) Certificate of Eligibility *(VA Forms 26-1870, 26-8320 or 26-8320-1)* (if VA loan); and (7) Any other data or documents as may be required. For refinancing loans, a separate statement signed by the borrower must be submitted itemizing those debts to be paid from loan proceeds and identifying those which are secured by liens of record. For VA loans in which the funds will be wholly or partially disbursed for home improvement purposes, lender must submit VA Form 26-1816, Rider for Application for Home Improvement Loan.

Items not identified in the following listing are self-explanatory.

ITEM 1. Enter the case number shown on the individual VA Certificate of Reasonable Value or HUD Statement of Appraised Value. Do not enter the case number assigned to a Master Certificate of Reasonable Value (VA Form 26-1843a).

ITEM 3. For VA loans name must be shown as it appears on the veteran's Certificate of Eligibility, VA Forms 26-8320, 26-1870, or 26-8320-1.

ITEM 4B. HUD only, enter originator's ID. ITEM 4C. HUD only, enter sponsor ID.

ITEMS 5A through 6C. Voluntary information for government monitoring purposes. The lender MUST inform the borrower of the following: The information concerning race/national origin and sex is requested by the Federal Government to monitor the lender's compliance with Equal Credit Opportunity and Fair Housing Laws. The law provides that a lender may neither discriminate on the basis of this information nor on whether or not it is furnished. Furnishing this information is optional. If the borrower or coborrower does not wish to furnish the information, he or she may initial in the appropriate place. Items 6A through 6C are not to be completed on non-coborrower spouse.

ITEM 7. Enter the complete address of the property to secure the loan. Describe on a separate sheet non-realty items, if any, to be acquired with proceeds of the loan.

ITEMS 8D and 8E. Any discount to be paid by the borrower is to be shown in Item 8D, expressed as the percentage of the loan amount the discount represents. In Item 8E enter the dollar amount charged. The discount must not be in excess of the prevailing rate being charged by lenders generally for loans to purchase similar properties with FHA or GI loan financing in the area in which the property to secure this loan is located. No discount may be charged to the VA borrower unless the proceeds of the loan are to be used for one of the purposes described in 38 U.S.C. 1803(c)(3). Under HUD transactions borrower may pay discounts permitted under 24 CFR 203.27. Questions as to eligibility of a particular case should be addressed to the local office prior to submission of the appropriate application. For VA only, documentation supporting such eligibility must be submitted with every loan application in which it is proposed that the veteran pay a discount, except for refinancing loans.

ITEM 9A. Check the appropriate box. If the borrower is purchasing a home on a "turnkey" basis which has not been completed and the loan will be closed after completion of construction in accordance with plans and specifications upon which VA or HUD based its value, check "purchase existing home not previously occupied." If the borrower is purchasing a condominium unit that has not been previously occupied, check "New." If the unit has been previously occupied, check "Existing."

ITEM 14. These estimates should be determined by the lender, not the seller. Extreme care should be exercised in making this determination in order to avoid underestimation of taxes and assessments. In the case of existing construction previously occupied, the taxes and assessments are usually a matter of record and should be the same as paid the previous year plus any additional tax caused by an increase in rate or assessment already approved or reasonably contemplated. In the case of new construction not yet assessed, the lender's estimate should be realistic and based upon taxes on similar properties in the locality or written estimates of the assessed value furnished by the tax assessor. Unless the tax and assessment are realistic, the T&I deposits cannot be estimated with any degree of accuracy.

ITEM 14B. Amount of hazard insurance required by the lender should not exceed the insurable value of the improvements or the loan amount, whichever is the lesser.

ITEM 14F. If the property is subject to maintenance assessment by compulsory membership homes association, or if the property is a condominium unit, state current annual amount of assessment.

ITEM 15. In Item 15A enter the principal and interest portion of the monthly payment. In Item 15B enter the necessary monthly deposits for the payment of real estate taxes and insurance. In Item 15C, "Other," show any special deposits necessary to pay special assessments when due, ground rents where applicable, etc.

ITEM 16. Lenders should refer to the Equal Credit Opportunity Act and Regulation B promulgated by the Federal Reserve Board pursuant thereto for restrictions on requests for information concerning the borrower's spouse.

ITEM 17B. Complete only if there is a co-borrower who is not the borrower's spouse.

ITEM 21. List all assets of the borrower(s) in this section. Under Item 21C, enter a realistic current value of any real estate. If encumbered, identify secured creditor(s) and show monthly payments and balance due in Item 22 or by a separate enclosure. If credit report does not contain payment record on the secured obligations on real estate, submit statement from creditor(s) verifying current status of obligation(s) and payment experience. In Item 21F list all other assets.

ITEM 22. List by firm name of creditor, all of the borrower's liabilities *(and any separate liabilities of the spouse, if applicable)* including the monthly payments and balance due on all obligations outstanding. If the credit report does not reflect the repayment record of debt(s) shown in this section, verification of the debt(s) by the creditor must be submitted with this application. In this connection, all references furnished by the borrower must be reported to the credit bureau when ordering a report. All outstanding debt(s) listed on the credit report must be listed in Item 22. Attach separate sheet(s) if necessary. For "Job Related Expense" show any costs for dependent care, union dues, significant commuting costs, group hospitalization insurance, etc.

ITEM 23. Enter the occupation of the borrower and spouse, if applicable, the names of their employers and the number of years each has been employed by present employer. If less than two years attach a verification of prior employment. Under Item 23D, show current monthly gross pay exclusive of overtime pay. Show also the hourly rate of pay if the borrower's or spouse's pay is based upon an hourly wage scale. Under item 23E, show any additional income from investments, pensions, VA compensation, part-time employment, etc., and current overtime pay. All income shown under Item 23 must be verified and a copy of the verification submitted with this form.

ITEM 24A. If the loan is for the purchase of an existing home or a house under construction which the borrower is buying on a "turnkey" basis, show the purchase price.

ITEM 24B. For improvement loans show total cost of improvements. If in addition to the purchase price of the existing property, an additional amount is to be included for alterations, improvements or repairs, list the cost of such items.

ITEM 24C. If the loan is for the construction of a home, list the contract price.

ITEM 24D. If the loan is for the construction of a home and the land is being acquired or has been acquired separately, list the cost of the land.

ITEM 24E. If the loan is for the purchase of an existing or proposed residential unit in a condominium or project development, enter the purchase price.

ITEM 24F. Show total refinancing amount exclusive of closing costs, prepaid items and discount. Submit statement described in required exhibits above.

ITEM 24H. Should reflect the aggregate total closing costs exclusive of discount to be shown in Item 24I. These costs may not be in excess of those permitted in VA Regulations, 38 CFR 36.4312 or HUD Regulations, 24 CFR 203.27. If there is any question as to the propriety of the estimated loan closing costs, the lender should itemize them on a separate attachment.

ITEM 24I. Enter same amount as Item 8E.

ITEM 24L. Should reflect any credits other than cash from the borrower; i.e., closing costs paid by seller, note or second trust given by borrower. Provide explanation on separate sheet, if necessary.

ITEM 24M. Enter same amount as Item 8A.

REVERSE OF FORM

SECTION III - Lender's Certifications. Items 26G through 26I are applicable for VA loans only. Item 26G must be appropriately completed for every VA loan submission. Items 27 through 30 must be dated and signed by an authorized official of the lending institution.

SECTION V - Borrower's Certifications. The applicable certifications must be completed and the form must be signed by the borrower and dated AFTER it has been completed and AFTER the borrower has been notified of the VA reasonable value or the HUD/FHA statement of appraised value. The form must not be signed in blank. *(Reference: 38 U.S.C. 1804(c); VA Regulations 38 CFR 36.4303(J) and 38 CFR 36.4336(A).)*

IMPORTANT

Remove this instruction sheet. The reverse of this instruction sheet may be used as a worksheet or extra copy for the lender. When the lender prepares the original Application, the interleaved carbons will transfer the identifying information to the "built-in" Certificate of Commitment and the copies thereof. Copy 6 of the completed form will be given to the borrower. The borrower's statement of liability, nondiscrimination certification and other certifications to be completed by the borrower and the lender are on the reverse of the application. The borrower must read, acknowledge and sign the reverse of the VA's or HUD's copy before submission to the Agency. After the application is completed for VA loans, detach copies 4 through 8 and forward the balance of the form to VA. For HUD/FHA loans, detach copies 1, 4, 5, and 7 and forward them to HUD.

VA Form 26-1802a, HUD 92900
JUN 1985

1)

Form Approved
OMB No. 2900-0144

☐ VA Application for Home Loan Guaranty	☐ USDA-FmHA Application for FmHA Guaranteed Loan	☐ HUD/FHA Application for Commitment for Insurance under the National Housing Act	1. AGENCY CASE NUMBER ▲	2A. LENDER'S CASE NUMBER	2B. SECTION OF THE ACT *(HUD Only)*

3. NAME AND PRESENT ADDRESS OF BORROWER *(Include ZIP Code)*

4A. NAME AND ADDRESS OF LENDER *(Include ZIP Code)*

4B. ORIGINATORS' I.D. *(HUD Only)*

4C. SPONSOR'S I.D. *(HUD Only)*

5A. BORROWER: *If you do not wish to complete Items 5B or 5C, please initial in the space to the right.* INITIALS

5B. RACE/NATIONAL ORIGIN
▲1 ☐ WHITE, NOT HISPANIC 4 ☐ ASIAN OR PACIFIC ISLANDER
2 ☐ BLACK, NOT HISPANIC 5 ☐ HISPANIC
3 ☐ AMERICAN INDIAN OR ALASKAN NATIVE

5C. SEX
▲1 ☐ MALE
2 ☐ FEMALE

6A. SPOUSE OR OTHER BORROWER: *If you do not wish to complete Items 6B or 6C, please initial in space to the right.* INITIALS

6B. RACE/NATIONAL ORIGIN
▲1 ☐ WHITE, NOT HISPANIC 4 ☐ ASIAN OR PACIFIC ISLANDER
2 ☐ BLACK, NOT HISPANIC 5 ☐ HISPANIC
3 ☐ AMERICAN INDIAN OR ALASKAN NATIVE

6C. SEX
▲1 ☐ MALE
2 ☐ FEMALE

7. PROPERTY ADDRESS INCLUDING NAME OF SUBDIVISION, LOT AND BLOCK NO., AND ZIP CODE	8A. LOAN AMOUNT $	8B. INT. RATE %	8C. PROPOSED MATURITY YRS. MOS.
	DISCOUNT: *(Only if borrower to pay)* ➡	8D. PERCENT %	8E. AMOUNT $

VA ONLY: Veteran and lender hereby apply to the Administrator of Veterans Affairs for Guaranty of the loan described here under Section 1810, Chapter 37, Title 38, United States Code to the full extent permitted by the veteran's entitlement and severally agree that the Regulations promulgated pursuant to Chapter 37, and in effect on the date of the loan shall govern the rights, duties, and liabilities of the parties.
HUD/FHA ONLY: Mortgagee's application for mortgagor approval and commitment for mortgage insurance under the National Housing Act.

SECTION I - PURPOSE, AMOUNT, TERMS OF AND SECURITY FOR PROPOSED LOAN

9A. PURPOSE OF LOAN – TO:
▲1 ☐ PURCHASE EXISTING HOUSE PREVIOUSLY OCCUPIED
2 ☐ FINANCE IMPROVEMENTS TO EXISTING PROPERTY
3 ☐ REFINANCE
4 ☐ PURCHASE NEW CONDO. UNIT
5 ☐ PURCHASE EXISTING CONDO. UNIT
6 ☐ PURCHASE EXISTING HOME NOT PREVIOUSLY OCCUPIED
7 ☐ CONSTRUCT A HOME - PROCEEDS TO BE PAID OUT DURING CONSTRUCTION
8 ☐ HUD ONLY – FINANCE COOP-PURCHASE

9B. HUD ONLY – BORROWER WILL BE
▲1 ☐ OCCUPANT
2 ☐ LANDLORD
3 ☐ BUILDER
4 ☐ OPERATIVE BUILDER
5 ☐ ESCROW COMMITMENT

10. VA ONLY – TITLE WILL BE VESTED IN:
☐ VETERAN ☐ VETERAN AND SPOUSE
☐ OTHER *(Specify)*

11. LIEN: ☐ FIRST MORTGAGE ☐ OTHER *(Specify)*

12. ESTATE WILL BE: ☐ FEE SIMPLE ☐ LEASEHOLD *(Show expiration date)*

13. IS THERE A MANDATORY HOMEOWNERS ASSOC.? ☐ YES ☐ NO *(If "Yes," complete Item 14F.)*

14. ESTIMATED TAXES, INSURANCE AND ASSESSMENTS		15. ESTIMATED MONTHLY PAYMENT	
A. ANNUAL TAXES	$	A. PRINCIPAL AND INTEREST	$
B. AMOUNT OF HAZARD INSURANCE ON SECURITY		B. TAXES AND INSURANCE DEPOSITS	
C. ANNUAL HAZARD INSURANCE PREMIUM		C. OTHER	
D. ANNUAL SPECIAL ASSESSMENT PAYMENT			
E. UNPAID SPECIAL ASSESSMENT BALANCE			
F. ANNUAL MAINTENANCE ASSESSMENT		TOTAL	$

SECTION II - PERSONAL AND FINANCIAL STATUS OF APPLICANT

16. PLEASE CHECK APPROPRIATE BOX(ES). IF ONE OR MORE ARE CHECKED, ITEMS 18B, 21, 22 AND 23 MUST INCLUDE INFORMATION CONCERNING BORROWER'S SPOUSE *(or former spouse if box "D" is checked)*. IF NO BOXES ARE CHECKED, NO INFORMATION CONCERNING THE SPOUSE NEED BE FURNISHED IN ITEMS 18B, 21, 22 AND 23.

A. ☐ THE SPOUSE WILL BE JOINTLY OBLIGATED WITH THE BORROWER ON THE LOAN
B. ☐ THE BORROWER IS RELYING ON THE SPOUSE'S INCOME AS A BASIS FOR REPAYMENT OF THE LOAN.
C. ☐ THE BORROWER IS MARRIED AND THE PROPERTY TO SECURE THE LOAN IS LOCATED IN A COMMUNITY PROPERTY STATE.
D. ☐ THE BORROWER IS RELYING ON ALIMONY, CHILD SUPPORT, OR SEPARATE MAINTENANCE PAYMENTS FROM A SPOUSE OR FORMER SPOUSE AS A BASIS FOR REPAYMENT OF THE LOAN.

17A. MARITAL STATUS OF BORROWER ▲ 1 ☐ MARRIED 3 ☐ UNMARRIED 2 ☐ SEPARATED	17B. MARITAL STATUS OF COBORROWER OTHER THAN SPOUSE ▲ 1 ☐ MARRIED 3 ☐ UNMARRIED 2 ☐ SEPARATED	17C. MONTHLY CHILD SUPPORT OBLIGATION $	17D. MONTHLY ALIMONY OBLIGATION $	18A. AGE OF BORROWER	18B. AGE OF SPOUSE OR COBORROWER	18C. AGE(S) OF DEPENDENT(S)

19. NAME AND ADDRESS OF NEAREST LIVING RELATIVE *(Include telephone number, if available).*

20A. CURRENT MONTHLY HOUSING EXPENSE $

20B. UTILITIES INCLUDED? ☐ YES ☐ NO

21. ASSETS		22. LIABILITIES *(Itemize all debts)*		
		NAME OF CREDITOR	MO. PAYMENT	BALANCE
A. CASH *(Including deposit on purchase)*	$		$	$
B. SAVINGS BONDS - OTHER SECURITIES				
C. REAL ESTATE OWNED				
D. AUTO				
E. FURNITURE AND HOUSEHOLD GOODS				
F. OTHER *(Use separate sheet, if necessary)*		JOB-RELATED EXPENSE *(Specify)*		
G. TOTAL	$	TOTAL	$	$

23. INCOME AND OCCUPATIONAL STATUS				
ITEM	BORROWER		SPOUSE OR COBORROWER	
A. OCCUPATION				
B. NAME OF EMPLOYER				
C. NUMBER OF YEARS EMPLOYED				
D. GROSS PAY	▲ MONTHLY $	HOURLY $	▲ MONTHLY $	HOURLY $
E. OTHER INCOME *(Disclosure of child support, alimony and separate maintenance income is optional.)*	▲ MONTHLY $		▲ MONTHLY $	

NOTE – If land acquired by separate transaction, complete Items 25A and 25B.

25A. DATE ACQUIRED

25B. UNPAID BALANCE $

24. ESTIMATED TOTAL COST	
ITEM	AMOUNT
A. PURCHASE EXISTING HOME	$
B. ALTERATIONS, IMPROVEMENTS, REPAIRS	
C. CONSTRUCTION	
D. LAND *(If acquired separately)*	
E. PURCHASE OF CONDOMINIUM UNIT	
F. REFINANCE	
G. PREPAID ITEMS	
H. ESTIMATED CLOSING COSTS	
I. DISCOUNT *(Only if borrower permitted to pay)*	
J. TOTAL COSTS *(Add Items 24A through 24I)*	
K. LESS CASH FROM BORROWER	
L. LESS OTHER CREDITS	
M. AMOUNT OF LOAN	$

VA FORM 26-1802a, JAN 1985
HUD FORM 92900.1

EXISTING STOCKS OF VA FORM 26-1802A, JAN 1982, WILL BE USED.

VA/HUD COPY 1

SECTION III - LENDER'S CERTIFICATION *(Must be signed by lender)*

The undersigned lender makes the following certifications to induce the Veterans Administration to issue a certificate of commitment to guarantee the subject loan under Title 38, U.S. Code, or to induce the Department of Housing and Urban Development - Federal Housing Commissioner to issue a firm commitment for mortgage insurance under the National Housing Act.

26A. The information furnished in Section I is true, accurate and complete.
26B. The information contained in Section II was obtained directly from the borrower by a full-time employee of the undersigned lender or its duly authorized agent and is true to the best of the lender's knowledge and belief.
26C. The credit report submitted on the subject borrower *(and spouse, if any)* was ordered by the undersigned lender or its duly authorized agent directly from the credit bureau which prepared the report and was received directly from said credit bureau.
26D. The verification of employment and verification of deposits were requested and received by the lender or its duly authorized agent without passing through the hands of any third persons and are true to the best of the lender's knowledge and belief.
26E. This application was signed by the borrower after Sections I, II and V were completed.
26F. This proposed loan to the named borrower meets the income and credit requirements of the governing law in the judgment of the undersigned.
26G through 26I - TO BE COMPLETED OR APPLICABLE FOR VA LOANS ONLY.
26G. The names and functions of any duly authorized agents who developed on behalf of the lender any of the information or supporting credit data submitted are as follows:

	NAME	ADDRESS	FUNCTION *(e.g., obtained information in Sec. II; ordered credit report, verification of employment, verif. of deposits, etc.)*
(1)			
(2)			
(3)			

☐ *(Check box if all information and supporting credit data were obtained directly by the lender.)*

26H. The undersigned lender understands and agrees that it is responsible for the acts of agents identified in item 26G as to the functions with which they are identified.
26I. The proposed loan conforms otherwise with the applicable provisions of Title 38, U.S. Code, and of the regulations concerning guaranty or insurance of loans to veterans.

27. Date	28. Name of Lender	29. Telephone Number *(Include Area Code)*	30. Signature and Title of Officer of Lender

SECTION IV - NOTICE TO BORROWERS

PRIVACY ACT INFORMATION - The information requested in this form is authorized by 38 U.S.C. 1810 *(if VA)* and 12 U.S.C. 1701 et seq., *(if HUD/FHA)* and will be used in determining whether you qualify as a mortgagor. Any disclosure of information outside VA or HUD/FHA will only be made as permitted by law. Disclosure of this information is voluntary but no loan may be approved unless a completed application is received.
NOTICE TO BORROWERS - This is notice to you as required by the Right to Financial Privacy Act of 1978 that the VA or HUD/FHA has a right of access to financial records held by financial institutions in connection with the consideration or administration of assistance to you. Financial records involving your transaction will be available to VA and HUD/FHA without further notice or authorization but will not be disclosed or released to another Government Agency or Department without your consent except as required or permitted by law.

SECTION V - BORROWERS CERTIFICATION *(Must be signed by Borrower(s))*

31A. COMPLETE FOR HUD/FHA INSURED MORTGAGE ONLY.

(1) Do you own or have you sold, within the past 12 months, other real estate? ☐ Yes ☐ No Is it to be sold? ☐ Yes ☐ No HUD/FHA Mortgage? ☐ Yes ☐ No

Sales Price $________________

Original Mortgage Amount $________________

Address: ________________________ Lender: ________________________

(2) Have you ever been obligated on a home loan, home improvement loan or a mobile home loan which resulted in foreclosure, transfer of title in lieu of foreclosure or judgment? ☐ Yes ☐ No. If "Yes" give details including date, property address, name and address of lender, FHA or VA Case Number, if any, and reasons for the action.

(3) If dwelling to be covered by this mortgage is to be rented, is it a part of, adjacent or contiguous to any project, subdivision, or group rental properties involving eight or more dwelling units in which you have any financial interest? ☐ Yes ☐ No ☐ Not to be rented. If "Yes" give details. Do you own four or more dwelling units with mortgages insured under any title of the National Housing Act? ☐ Yes ☐ No. If "Yes" submit form HUD-92561.

31B. APPLICABLE FOR BOTH VA AND HUD. As a home loan borrower, you will be legally obligated to make the mortgage payments called for by your mortgage loan contract. The fact that you dispose of your property after the loan has been made WILL NOT RELIEVE YOU OF LIABILITY FOR MAKING THESE PAYMENTS. PAYMENT OF THE LOAN IN FULL IS ORDINARILY THE WAY LIABILITY ON A MORTGAGE NOTE IS ENDED.
Some home buyers have the mistaken impression that if they sell their homes when they move to another locality, or dispose of it for any other reasons, they are no longer liable for the mortgage payments and that liability for these payments is solely that of the new owners. Even though the new owners may agree in writing to assume liability for your mortgage payments, this assumption agreement will not relieve you from liability to the holder of the note which you signed when you obtained the loan to buy the property. Also, unless you are able to sell the property to a buyer who is acceptable to the VA or to HUD/FHA and who will assume the payment of your obligation to the lender, you will not be relieved from liability to repay any claim which the VA or HUD/FHA may be required to pay your lender on account of default in your loan payments. The amount of any such claim payment will be a debt owed by you to the Federal Government. This debt will be the object of established collection procedures.

I, THE UNDERSIGNED BORROWER(S) CERTIFY THAT:

(1) I have read and understand the foregoing concerning my liability on the loan.

(2) VA Only *(check applicable box)* ☐ Purchase or Construction Loan. I now actually occupy the above-described property as my home or intend to move into and occupy said property as my home within a reasonable period of time. ☐ Home Improvement or Refinancing Loan. I own and personally occupy as my home the property described in Item 7 of the Application.

(3) Check applicable box *(not applicable for Home Improvement or Refinancing Loan)*. I have been informed that $ is ☐ the reasonable value of the property as determined by the VA, ☐ the statement of appraised value as determined by HUD/FHA. IF THE CONTRACT PRICE OR COST EXCEEDS THE VA REASONABLE VALUE OR HUD/FHA STATEMENT OF APPRAISED VALUE, COMPLETE EITHER ITEM (a) or (b), WHICHEVER IS APPLICABLE.

(a) ☐ I was aware of this valuation when I signed my contract and I have paid or will pay in cash from my own resources at or prior to loan closing a sum equal to the difference between the contract purchase price or cost and the VA or HUD/FHA established value. I do not and will not have outstanding after loan closing any unpaid contractual obligation on account of such cash payment;

(b) ☐ I was not aware of this valuation when I signed my contract but have elected to complete the transaction at the contract purchase price or cost. I have paid or will pay in cash from my own resources at or prior to loan closing a sum equal to the difference between contract purchase price or cost and the VA or HUD/FHA established value. I do not and will not have outstanding after loan closing any unpaid contractual obligation on account of such cash payment.

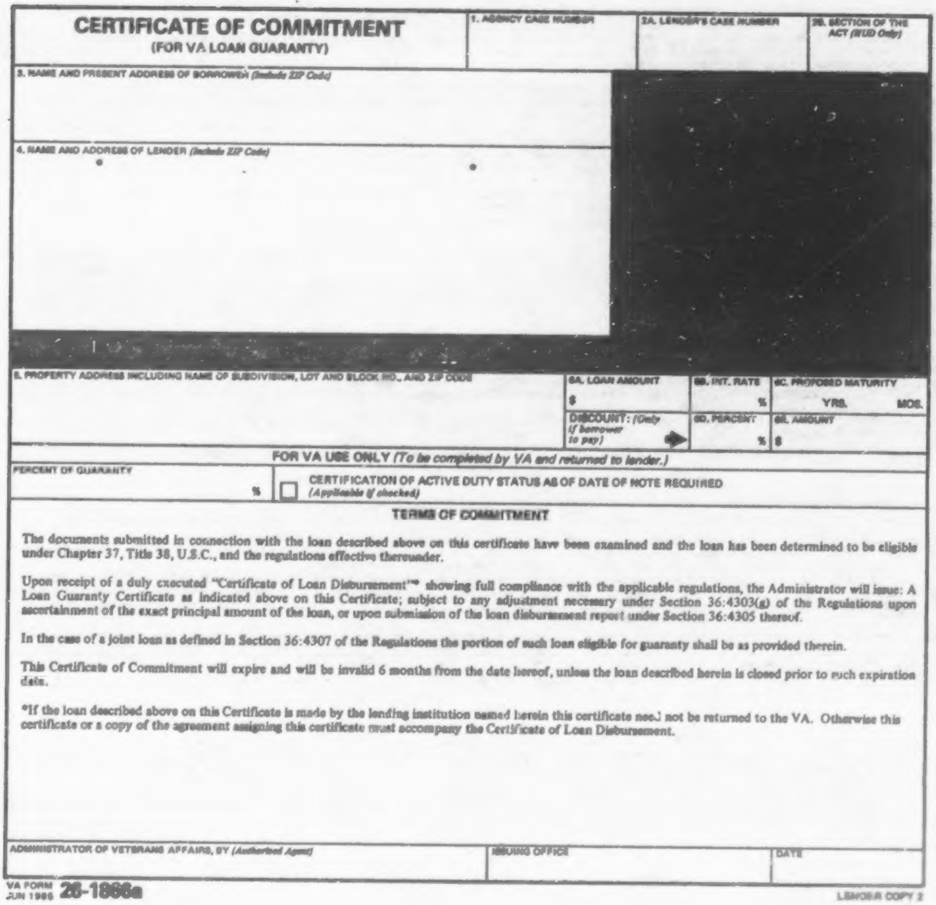
(4) Neither I, nor anyone authorized to act for me, will refuse to sell or rent, after the making of a bona fide offer, or refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny the dwelling or property covered by this loan to any person because of race, color, religion, sex or national origin. I recognize that any restrictive covenant on this property relating to race, color, religion, sex or national origin is illegal and void and civil action for preventive relief may be brought by the Attorney General of the United States in any appropriate U.S. District Court against any person responsible for the violation of the applicable law.

(5) The Borrower certifies that all information in this application is given for the purpose of obtaining a loan to be insured under the National Housing Act, or guaranteed by the Veterans Administration and the information in Section II is true and complete to the best of his/her knowledge and belief. Verification may be obtained from any source named herein.

HUD ONLY
(6) For properties constructed prior to 1950 - I have received the brochure "Watchout for Lead Paint Poisoning" ☐ ☐ NA
(7) ☐ I have read and understand the contents of the Home Energy Checklist attached to HUD-92800-4.

READ CERTIFICATIONS CAREFULLY - DO NOT SIGN UNLESS APPLICATION IS FULLY COMPLETED.	32. DATE	33. SIGNATURE OF BORROWER(S) *(Before signing, review accuracy of application and certifications.)*

Federal statutes provide severe penalties for any fraud, intentional misrepresentation, or criminal connivance or conspiracy purposed to influence the issuance of any guaranty or insurance by the VA or USDA-FmHA Administrator or the HUD/FHA Commissioner.



CERTIFICATE OF COMMITMENT (FOR VA LOAN GUARANTY)	1. AGENCY CASE NUMBER	2A. LENDER'S CASE NUMBER	2B. SECTION OF THE ACT *(HUD Only)*

3. NAME AND PRESENT ADDRESS OF BORROWER *(Include ZIP Code)*

4. NAME AND ADDRESS OF LENDER *(Include ZIP Code)*

[redacted]

5. PROPERTY ADDRESS INCLUDING NAME OF SUBDIVISION, LOT AND BLOCK NO., AND ZIP CODE	6A. LOAN AMOUNT $	6B. INT. RATE %	6C. PROPOSED MATURITY YRS. MOS.
	DISCOUNT: *(Only if borrower to pay)*	6D. PERCENT %	6E. AMOUNT $

FOR VA USE ONLY *(To be completed by VA and returned to lender.)*

PERCENT OF GUARANTY %	☐ CERTIFICATION OF ACTIVE DUTY STATUS AS OF DATE OF NOTE REQUIRED *(Applicable if checked)*

TERMS OF COMMITMENT

The documents submitted in connection with the loan described above on this certificate have been examined and the loan has been determined to be eligible under Chapter 37, Title 38, U.S.C., and the regulations effective thereunder.

Upon receipt of a duly executed "Certificate of Loan Disbursement"* showing full compliance with the applicable regulations, the Administrator will issue: A Loan Guaranty Certificate as indicated above on this Certificate; subject to any adjustment necessary under Section 36:4303(g) of the Regulations upon ascertainment of the exact principal amount of the loan, or upon submission of the loan disbursement report under Section 36:4305 thereof.

In the case of a joint loan as defined in Section 36:4307 of the Regulations the portion of such loan eligible for guaranty shall be as provided therein.

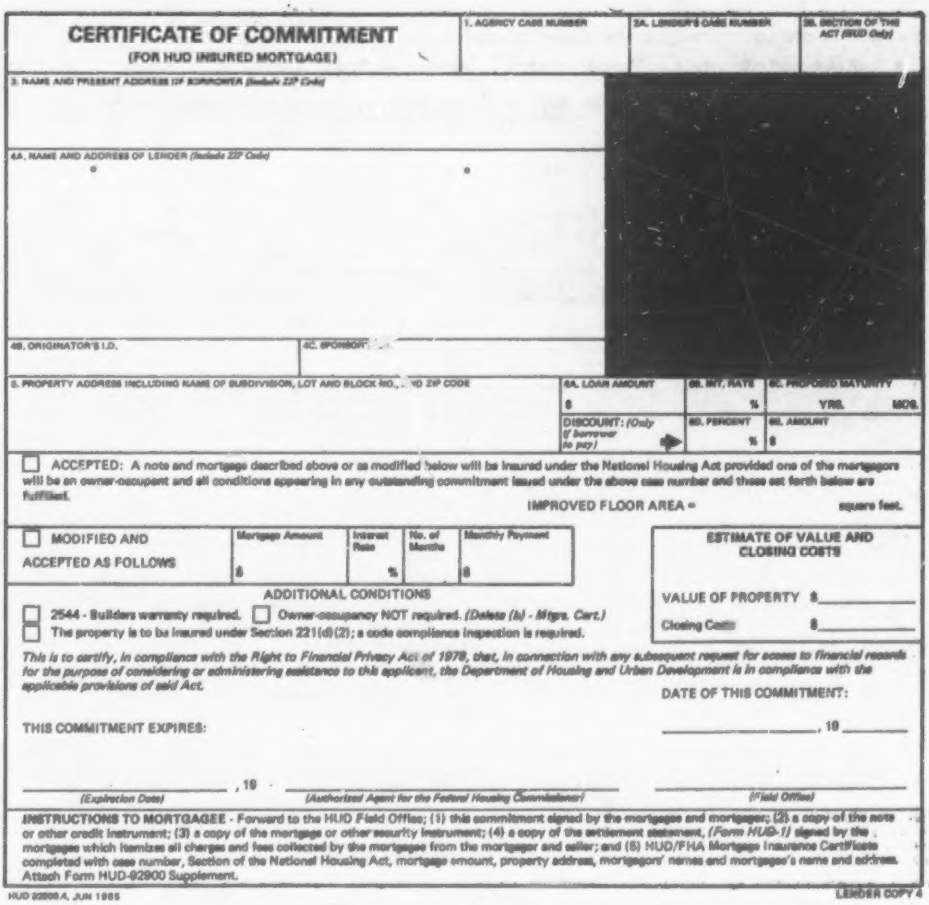
This Certificate of Commitment will expire and will be invalid 6 months from the date hereof, unless the loan described herein is closed prior to such expiration date.

*If the loan described above on this Certificate is made by the lending institution named herein this certificate need not be returned to the VA. Otherwise this certificate or a copy of the agreement assigning this certificate must accompany the Certificate of Loan Disbursement.

ADMINISTRATOR OF VETERANS AFFAIRS, BY *(Authorized Agent)*	ISSUING OFFICE	DATE

VA FORM JUN 1985 **26-1866a**

LENDER COPY 2



CERTIFICATE OF COMMITMENT
(FOR HUD INSURED MORTGAGE)

1. AGENCY CASE NUMBER

2A. LENDER'S CASE NUMBER

2B. SECTION OF THE ACT *(HUD Only)*

3. NAME AND PRESENT ADDRESS OF BORROWER *(Include ZIP Code)*

4A. NAME AND ADDRESS OF LENDER *(Include ZIP Code)*

4B. ORIGINATOR'S I.D.

4C. SPONSOR

5. PROPERTY ADDRESS INCLUDING NAME OF SUBDIVISION, LOT AND BLOCK NO., AND ZIP CODE

6A. LOAN AMOUNT $

6B. INT. RATE %

6C. PROPOSED MATURITY YRS. MOS.

DISCOUNT: *(Only if borrower to pay)*

6D. PERCENT %

6E. AMOUNT $

☐ ACCEPTED: A note and mortgage described above or as modified below will be insured under the National Housing Act provided one of the mortgagors will be an owner-occupant and all conditions appearing in any outstanding commitment issued under the above case number and those set forth below are fulfilled.

IMPROVED FLOOR AREA = square feet.

	Mortgage Amount	Interest Rate	No. of Months	Monthly Payment
☐ MODIFIED AND ACCEPTED AS FOLLOWS	$	%		$

ESTIMATE OF VALUE AND CLOSING COSTS

VALUE OF PROPERTY $__________

Closing Costs $__________

ADDITIONAL CONDITIONS

☐ 2544 - Builders warranty required. ☐ Owner-occupancy NOT required. *(Delete (b) - Mtgrs. Cert.)*

☐ The property is to be insured under Section 221(d)(2); a code compliance inspection is required.

This is to certify, in compliance with the Right to Financial Privacy Act of 1978, that, in connection with any subsequent request for access to financial records for the purpose of considering or administering assistance to this applicant, the Department of Housing and Urban Development is in compliance with the applicable provisions of said Act.

DATE OF THIS COMMITMENT:

________________, 19 ______

THIS COMMITMENT EXPIRES:

________________, 19
(Expiration Date)

____
(Authorized Agent for the Federal Housing Commissioner)

____
(Field Office)

INSTRUCTIONS TO MORTGAGEE - Forward to the HUD Field Office; (1) this commitment signed by the mortgagee and mortgagor; (2) a copy of the note or other credit instrument; (3) a copy of the mortgage or other security instrument; (4) a copy of the settlement statement, *(Form HUD-1)* signed by the mortgagee which itemizes all charges and fees collected by the mortgagee from the mortgagor and seller; and (5) HUD/FHA Mortgage Insurance Certificate completed with case number, Section of the National Housing Act, mortgage amount, property address, mortgagors' names and mortgagee's name and address. Attach Form HUD-92900 Supplement.

HUD 92900 A, JUN 1985

LENDER COPY 4

MORTGAGOR'S CERTIFICATE - The undersigned certifies that:

(a) I will not have outstanding any other unpaid obligations contracted in connection with the mortgage transaction or the purchase of the said property except obligations which are secured by property or collateral owned by me independently of the said mortgaged property, or obligations approved by the Commissioner.

(b) One of the undersigned is the occupant of the subject property. *(NOTE: Delete item (b) if owner occupancy not required by commitment.)*

(c) All charges and fees collected from me as shown in the settlement statement have been paid from my own funds, and no other charges have been or will be paid by me in respect to this transaction.

(d) Check applicable box:

☐ Amendatory clause not required in this transaction.

☐ The FHA Statement of Appraised Value or VA Certificate of Reasonable Value was given to me prior to my signing the purchase contract for the property.

☐ The FHA Statement of Appraised Value or VA Certificate of Reasonable Value was not received by me prior to my signing the contract to purchase, but the contract to purchase contained the following language: "It is expressly agreed that, notwithstanding any other provisions of this contract the purchaser shall not be obligated to complete the purchase of the property described herein or to incur any penalty by forfeiture of earnest money deposits or otherwise unless the seller has delivered to the purchaser a written statement issued by the Federal Housing Commissioner setting forth the appraised value of the property *(excluding closing costs)* of not less than $ which statement the seller hereby agrees to deliver to the purchaser promptly after such appraised value statement is made available to the seller. The purchaser shall, however, have the privilege and option of proceeding with the consummation of the contract without regard to the amount of the appraised valuation made by the Federal Housing Commissioner. The appraised valuation is arrived at to determine the maximum mortgage the Department of Housing and Urban Development will insure. HUD does not warrant the value or the condition of the property. The purchaser should satisfy himself that the price and condition of the property are acceptable.

(IF THE AMENDMENT PROCEDURE WAS NECESSARY, THE DOLLAR AMOUNT USED IN THE AMENDATORY CLAUSE IS INSERTED IN THE ABOVE BLANK.)

(e) Neither I, nor anyone authorized to act for me, will refuse to sell or rent, after the making of a bona fide offer, or refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny the dwelling or property covered by this loan to any person because of race, color, religion, sex, marital status or national origin. I recognize that any restrictive covenant on this property relating to race, color, religion, sex, marital status or national origin is illegal and void and any such covenant is hereby specifically disclaimed. I understand that civil action for preventative relief may be brought by the Attorney General of the United States in any appropriate U.S. District Court against any person responsible for a violation of this certification. NOTE: The interest rate shown is the FHA-VA maximum rate in effect on the date of this commitment and may increase prior to closing unless buyer and lender agree otherwise.

Signature(s):

Date: , 19

MORTGAGEE'S CERTIFICATE - The undersigned certifies that to the best of its knowledge:

Date: ____________________, 19 ______

(a) The statements made in its application for insurance and in the Mortgagor's Certificate are true and correct to our best knowledge.
(b) The conditions listed above or appearing in any outstanding commitment issued under the above case number have been fulfilled.
(c) Complete disbursement of the loan has been made to the Mortgagor, or to his creditors for his account and with his consent.
(d) The security instrument has been recorded and is a good and valid first lien on the property described.
(e) No charge has been made to or paid by the Mortgagor except as permitted under HUD Regulations.
(f) The copies of the credit and security instruments which are submitted herewith are true and exact copies as executed and filed for record.
(g) It has not paid any kickbacks, fees or consideration of any type, directly or indirectly, on or after May 1, 1972, to any party in connection with this transaction except as permitted under Section 203.7(a)(6) of the HUD Regulations and administrative instructions issued pursuant thereto.

NOTE: If commitment is executed by an agent in name of the mortgagee, the agent must enter the mortgagee's code number and type code number in blocks below.

Code

Type

Mortgagee *(Please use FHA imprint stamp, or other approved device.)*

Signature and title of officer

COPY 4 - MORTGAGOR/MORTGAGEE CERTIFICATE — IER COPY

Mr. **Steinberg**. You referred to a meeting this afternoon that you have with OMB. Is this an informal appeal on the VA's part or has the VA filed an official——

Mr. **Ivers**. We have not filed an official appeal. If you want to call it an informal appeal I guess that's——

Mr. **Steinberg**. You indicated that you anticipated that there would be a resolution.

Mr. **Ivers**. I think so.

Mr. **Steinberg**. Would you report back to the committee, please, on a timely basis—hopefully, not waiting the normal 6 to 8 weeks that it takes for a written response to filter back to us, but perhaps in the next 24 or 48 hours, to both the minority and majority—as to the disposition of that meeting. And, if that meeting does not produce a resolution, then please advise us as to what, if any, further steps the VA is going to take.

Mr. **Ivers**. Sure.

Mr. **Steinberg**. Thank you very much.

Mr. **Principi**. I have just one further question. It relates to the inventory.

You acquired properties from the lenders in approximately 90 percent of the cases. I believe it was as high as 95 and now it is down to 90 percent. In calculating the cost, the average loss per home, or the net value, I should say, do you include any lost interest or administrative cost that you incur as a result of managing those properties? What is included in that net value?

Mr. **O'Toole**. Well, that calculation is made in conformance with the Deficit Reduction Act and that's what we're doing, and that act does not require that those items be included in the calculation.

Mr. **Principi**. Should those items be included in the calculation?

Mr. **O'Toole**. Well, since the Congress determined what those calculations would be, any change to that I think would be appropriately made by the Congress, keeping in mind that anything that's included in that calculation results in a loss and the claim amount is chargeable back to the veteran purchaser.

Mr. **Principi**. Thank you very much. I appreciate your patience.

In the interest of time, I will call up the next witnesses from the private sector as a panel, giving each witness the opportunity to testify.

Mr. Steven Doehler of the Mortgage Insurance Companies of America; Mr. Ronnie Wynn, president of Colonial Mortgage Co. and the president of the Mortgage Bankers Association of America; Mrs. Dorcas Helfant, 1985 vice president for region IV, the National Association of Realtors; and Mr. David E. Smith, first vice president, National Association of Home Builders.

I apologize for the delay. In fact, the chairman is on the floor and he should be back momentarily.

I request that the witnesses summarize their testimony, and Mr. Steven Doehler.

TESTIMONY OF A PANEL CONSISTING OF: STEVEN P. DOEHLER, EXECUTIVE VICE PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA, WASHINGTON, DC; RONNIE J. WYNN, PRESIDENT OF COLONIAL MORTGAGE CO., MONTGOMERY, AL, AND VICE CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE MORTGAGE BANKERS ASSOCIATION, WASHINGTON, DC; MRS. DORCAS T. HELFANT, 1985 REGIONAL VICE PRESIDENT FOR REGION IV, CHAIR OF THE REALTOR VETERANS' ADMINISTRATION TASK FORCE, NATIONAL ASSOCIATION OF REALTORS, VIRGINIA BEACH, VA; AND DAVID E. SMITH, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, WASHINGTON, DC

Mr. DOEHLER. Thank you, Mr. Principi.

I appreciate being here and I thank the chairman of the committee.

I'm executive vice president of the Mortgage Insurance Companies of America, the association representing the entire private mortgage insurance industry. I will make some summary remarks from the written statement submitted for the record.

Mortgage insurance companies are monoline, which mean residential mortgage insurance is their sole insurance activity. They are intrinsically tied to the vitality of the housing industry.

The VA program has been operating for 40 years. It wasn't until the mid-seventies that private insurers began insuring a volume of mortgages equal to that guaranteed by the VA. In the last decade the number of families opting for privately insured loans has increased significantly.

In 1984 we insured almost five times the VA volume.

MICA has never focused upon the workings of the VA Home Loan Program primarily because the no-downpayment concept, the heart of the veterans' housing benefit, has always been beyond the legal capabilities of mortgage insurance companies. All State insurance laws require a minimum 5-percent downpayment on insurable loans.

Based on experience, veterans have generally been viewed to have higher credit standing than nonveterans. We have assumed the higher loss experience of the VA program to be a function of the no-downpayment lending. A private insurance 95-percent loan is typically 2 to 2½ times riskier than a 90-percent loan, so one would expect a very high loss experience on a 100-percent loan.

Unlike lender groups, MICA has never had a formal dialog with the VA on matters of common concerns, such as appraisal practices. There may be some benefits from certain actions we could jointly take that would help cut default losses and be in the best interest of veteran and nonveteran home buyers.

Today housing finance practices have changed the nature of the risk facing insurers. Corresponding changes and key underwriting decisions are warranted, and according to such bond rating agencies as Standard and Poors and Moody's, such changes hold serious financial implications for the insurer.

Thus, the high level of defaults and losses should raise questions both as to the cost of the program for the Government and how well the benefit is being provided to a veteran.

A mortgage default is generally surrounded by family hardship. So, if veterans are defaulting in high numbers, this should be of concern. Why are foreclosure losses high?

There are certainly many explanations, but the most important one at this time involves the new financing techniques that have developed over the past decade of high inflation. Such techniques are no longer appropriate in markets where home prices have stabilized or shown decline.

Past inflation has affected the perception of default risk through rapid home appreciation. However, individual borrowers with little or no equity and who experience payment difficulties continue to have less motivation to avoid foreclosure. If the value of a property is insufficient to produce a sales price that will cover the mortgage balance and the selling costs, a buyer may have no choice but to send the lender the key.

Credit and property underwriting practices are critical ingredients for an effective mortgage guarantee program, and they are most effective when there is a meaningful level of financial discipline involved. Private insurers operate according to the basic principle of coinsurance or risk sharing with the lender responsible for underwriting the loan.

Coinsurance simply means that if a borrower defaults the insurer provides coverage for the major portion but not all the risk. The lender risks loss to a degree generally related to his underwriting performance. Today, with the growth of the secondary market and other developments, coinsurance has been declining. At the same time some abusive lending practices are being promoted.

MICA applauds the VA's policy to acquire only properties securing VA loans where it is in the Government's best interest to do so. Abandoning the VA's predominant risk-free claim settlement approach adds reasonable financial discipline for lenders and strengthens the coinsurance principle.

Private insurers have followed the claim settlement approach of taking title only when loss mitigation is probable and this practice has never generated any complaints from the better performing mortgage lenders.

Examples of potentially abusive practices described in the statement include unsound financing terms, inflated appraisals, and poor loan underwriting and servicing. The advertisement attached to the statement is an example. Obviously, atypical of the general market, nonetheless all too common.

You will note this financing problem is being offered to a veteran as well as conventional borrowers. The terms are unsound. Payment shock, for example, is built into the schedule of annual borrower payment increases which can equal about 40 percent over 4 years. Not many veterans can expect that kind of income rise.

Also, in order to offer the below market rates, the builder has paid to lower the borrowers financing cost to the tune of about $13,500. If you subtract this amount from the $93,000 sales price you get a property whose value may be closer to $80,000. Even if you were to assume no profit taken by the builder, then the VA would likely be guaranteeing not just a no downpayment 100-percent loan, but as much as 115-percent loan.

Most importantly, when the VA permits the use of its guarantees on this type of financing, it not only is building more risk of loss for the Government, but is helping to drive the private marketplace toward abusive practices as lenders and others attempt to compete with such deceptive attractive mortgage terms.

The VA involvement in such financing practice is a misdirection of government resources that encourages loans that may not be in the best interest of veterans. Market practices are changing rapidly and errors that mortgage insurers make today may not surface for a number of years.

Thank you for this opportunity to present our views.

Mr. PRINCIPI. Thank you, Mr. Doehler.

[The prepared statement of Steven P. Doehler, executive vice president, Mortgage Insurance Companies of America, Washington, DC, follows:]

PREPARED STATEMENT OF STEVEN P. DOEHLER, EXECUTIVE VICE PRESIDENT, MORTGAGE INSURANCE COMPANIES OF AMERICA, WASHINGTON, DC

Mr. Chairman and Members of the Committee:

My name is Steven Doehler and I am Executive Vice President of the Mortgage Insurance Companies of America (MICA) the trade association that represents the entire industry of private mortgage insurance companies (MICs). In 1984 MICs insured 946,409 high ratio mortgage loans, almost five times the number of loans guaranteed by the VA.

Because MICs provide default insurance to lenders in much the same way that the VA does, MICA has been asked to comment today on fundamentals of mortgage insurance, including trends in the marketplace and changes that have occurred in lending practices. As a preface to this statement, it is important to note that because of state insurance laws designed to limit risk, MICs cannot insure loans where the buyer does not make at least a 5 percent downpayment. The no downpayment loan guarantee of the VA has always been beyond the capability of a private insurer.

From the legislative history it is clear that Congress selected the loan guaranty as a veteran housing benefit over a cash bonus approach or direct loan benefit because at that time this form of mortgage credit assistance fit most appropriately with (1) the needs of veterans, (2) the existing capabilities of the private housing finance system and (3) the effective cost to the government. These criteria are valid in an oversight review today. MICA strongly believes there should be no diminution in the housing assistance benefit for veterans. However, due to changes in housing, the financing system the method of delivery of the veterans' housing benefit and the need to use the program as an economic stimulus should be reexamined.

In evaluating the private or VA mortgage insurance programs today it is important to recognize a number of recent developments that have changed the nature of the risks facing insurers. Examples of these developments include higher levels of structural unemployment, lower property appreciation, reduction in co-insurance, aggressive mortgage origination practices and changing borrower attitudes toward default. These developments require changes in key underwriting decisions and hold implications for the claims experience and profitability of the insurer.

There are differences that should be noted in any comparison with the VA guaranty program and private insurers. According to internal studies that the VA has produced in the past, the majority of lenders generally rate the credit risk of veterans lower than non-veterans. This would translate into better underwriting experience for the VA than that for MICs. However, because many VA loans are initially made with 100% loan to value ratio, these higher risk loans are likely to raise total risk for the VA program. The majority of foreclosures tend to occur in the first few years when the borrower's equity is relatively small and the value of the property may be insufficient to cover the cost of sale and the outstanding loan amount. Individuals with little or no equity who experience repayment difficulties often lack the motivation to maintain their mortgage in good standing and foreclosures occur.

In both the VA and MIC insurance programs, credit underwriting practices are critical ingredients to their effectiveness. MICs, like other private firms, perform and are evaluated according to the financial discipline imposed by the "bottom line". They operate in a very competitive environment and if they are not able to provide a vital function for mortgage lenders, who also face daily competition, the consequences are obvious and immediate. A MIC must seek operating efficiencies, must seek economic pricing and underwriting practices, must seek to provide products and services that meet the needs of lenders serving American homebuyers. Operating in an uneconomic way for any period is not an option. Losses and claims will provide the ultimate performance record and are necessary to validate the role of the mortgage insurer.

As background on the market served by MICs, there have been shifts over the last several years so that MICs have greatly increased the number of families they serve with lower incomes.

In 1984, many families found private loans more affordable than government loans. Today, no real distinction can be made between the affordability of government and private loans by annual family income. Many borrowers receiving conventionally insured loans are first time homebuyers lacking accumulated savings for anything more than a minimum 5 percent downpayment. In 1984 over half of the MIC's business was on 95 percent loan to value mortgages. MICs do not keep statistics on the number of insured loans of borrowers with military service, but we assume the proportion is in line with that in the total population.

Because default is very much related to the economy and the level of employment, some questions are logically raised about why defaults and foreclosures have continued to remain high during 1983 and 1984 although the economy has gone through a rather robust recovery. One answer, of course, is that the overall structural level of unemployment in our economy has shifted upward. However, in this recent recovery period, the one factor absent in many housing markets has been a return to stable or rising home prices, greatly affecting the levels of borrowers' equity. During the 1970's many people considered the purchase of a home primarily for its investment aspects. Much of this thinking resulted from inflation's effect on housing prices and the resulting rapid equity buildup that homeowners received.

This inflationary period of the 1970's also influenced the techniques and methods of home financing and home selling.

When a family did meet with a disruption in income leading to default, in many cases the equity growth in the property would allow the family to avoid foreclosure. Again, when the level of borrower equity is insufficient to cover the cost of sale and to dispose of the obligation, evidence indicates that the borrower becomes more willing to default on his loan and allow foreclosure to occur. The high inflation of the 1970's tended to reduce default risk for lenders, MICs and the VA.

Many inflation based financing techniques have been carried over into the current economy and are creating difficulties for homebuyers today. The most common example is that of so called builder buydown loans used to reduce, usually for a temporary period, the borrower's financing costs. Buydowns help make the monthly payments more affordable and can be justified if inflation does soon bring the equity into line with the loan balance. Reasonable financing concessions incorporated into the selling price of the home can be workable. However, overly aggressive financing concessions are totally unacceptable in stable or declining markets. An insurer of mortgage default risk must adjust to these underwriting and operating challenges as financing methods change.

Another example of a trend affecting underwriting risk is the shift in the originating and holding of mortgage loans. Ten years ago the primary originators of mortgages were lenders who kept the loans in their own portfolios. Because making a bad loan hurt the lender directly, mortgage lending was fairly conservative from a risk perspective. Coinsurance, one of the major elements of mortgage insurance wherein the risk of default is shared by the insurance company and the loan originator, was alive and well. Today this principle has diminished in the eyes of many lenders. It is becoming common for lenders to say that they will make a loan if mortgage insurance companies will insure it and the loan can be sold in the secondary market. Investors in mortgages are looking to the MICs for quality control and are transforming the roles of MICs from that of a review underwriter to that of a primary underwriter.

This most disturbing trend was highlighted in an article in the January 1985 edition of Savings Institutions in which the Director of Research of the U.S. League of Savings Institutions stated:

> "Neither the builder, real estate broker, mortgage banker nor securities firm has a major stake in the quality of the mortgage loan assets sold in today's secondary market. The primary interest of each of these parties is in closing the deal for the sale of the house and doing so in the greatest possible volume. This pressure for maximum volume stands in direct conflict with the basic underwriting goal of quality.
>
> Those who do have a major interest in loan quality in the secondary market are the federal credit agencies and the private mortgage insurers. It is the existence of federal guarantees and private mortgage insurance that relieve Wall Street and mortgage securities investors of asset quality concerns."

Loan quality should be the responsibility of the lender and the mortgage insurer should operate as a review underwriter. In line with this principle, about four years ago many MICs had initiated new programs of delegated or automatic underwriting to increase productivity. The individual lenders were given the authority to review the income and credit of borrowers and obtain a commitment for insurance prior to a MIC's review of the documentation. Due to a very adverse experience from those programs, MICs have had to significantly cut back on delegating underwriting to where today it is used for less than 2 percent of insured loans. This would confirm the need for effective management controls on loans the VA guarantees on an "automatic basis" including a monitoring as to whether such loans demonstrate a less favorable default experience.

Another trend in practices of mortgage originators resulting in large part from the increased complexity in the transactions is that of increase incidents of fraud and misrepresentation. MIC's high losses are attributable in part to the consequences of situations involving fraudulent practices and mistatements. Insurers have had to react to the tendency on the part of some loan originators to abdicate responsibility for sound loan underwriting. Lenders involved in fraud or misrepresentation increasingly have had their claims challenged. Early in 1983, the Texas State Board of Insurance appointed a task force to draft a new master policy for use by MICs to specifically address new business practices in the changing mortgage market. Again, based upon MIC experience, the VA may need to begin more thorough investigation of claims to insure that there is a true risk sharing between the lender and insurer.

The VA should reject insurance claims resulting from fraudulent loans and on loans that do not conform to the VA requirements.

Other situations in residential lending where apparent problems have arisen for MICs include:

(1) Unsound financing terms for borrowers and "special" offers or excessive pressures to buy - Often in weak or overbuilt markets there are examples where third parties such as builders or sellers become excessively involved in determining the financing arrangements. Also transactions involving movement of the funds outside of closing or special arrangements are made to appear to be in the borrowers benefit but generally later turn sour. More common are loan arrangements with terms such as interest rates that are substantially lower than prevailing market rates. These rates are generally predicated upon financing concessions such as discount points paid by the seller that confuse the borrower as to the true cost of the financing or the true underlying value of the property.

From the standpoint of default and foreclosure, these unsound financing arrangements are discovered for what they are when and if the homebuyer wants or has to sell his property in the future. In almost all such cases the borrower (be he a veteran or not) discovers the real market value of the house is far lower than his purchase price. To illustrate this a typical advertisement is included as Attachment A.

While the financing offered in this advertisement is both conventional and VA guaranteed the basic problem is the same from a homebuyer's (or insurer's) perspective. In reading the ad's stated terms, the veteran is being offered a permanent rate buydown of over 1.5% in combination with a temporary 4-3-2-1 rate buydown. The borrower's payments are lower in the early years but he faces significant increases in his monthly payment. After the fourth year his payments will be almost 40% higher than in the first year, creating the likelihood of "payment shock". It is unlikely that the average veteran can expect a 40% increase in his salary during that same period. We question whether the VA should permit such loan terms for all veterans.

In addition, because of these terms, the sales price paid will remain substantially above the true market value of the house. Due to this high degree of borrower negative equity, higher foreclosures on such loans are predictable. An estimate of the present value of the discount financing offered by the builders for the home in the advertisement is about $13,000. If there was no downpayment made by the veteran and a default were to occur, the VA as insurer is likely to find a substantial loss. In such a case, the VA generally would be best off to pay the insurer the guaranteed amount in the same way that a MIC would approach such a claim. In most cases the VA would lose more money by choosing its option of keeping the property (rather than paying the claim) because there would be a high probability that such a property would be marginal and very hard to sell. Lenders who participate in such financing should not be treated to the VA's predominant risk free claim settlement approach where the insurer acquires the foreclosed property.

(2) Inflated Appraisal - Probably one of the key problems affecting the consumer is poor quality home appraisals. One appraiser recently highlighted this in a recent issue of the Appraiser Review Journal with an article entitled "You Can't Have Fraud Without an Appraisal." He summarized the problem as follows:

> "Our experience indicates that there is a direct relationship between poor quality loans and poor quality appraisal reports. An examination of loan packages that are in default revealed that 29 out of 30 properties were over appraised, many substantially. Further, a large sampling of loan appraisals, from properties that were not in default, revealed that 98% of the appraisers listed sales prices as market value. If sales price is market value the lender doesn't need the appraiser. The lender already knows the sales price."

Because borrowers pay for and expect that the appraisal of the home they are considering for purchase offers a reasonable check of market value, the appraiser assigned by the VA should be subject to meaningful discipline by the agency. Even though the VA probably is concerned with appraisals, we expect that they are meeting the same problem MICs have from the current inadequacy of the appraisal process. One immediate goal for the VA as a user of appraisals, should be to help encourage the development of some reasonable appraisal standards that will identify the effect of financing. Appraisals that hide unreasonable levels of seller paid financing or other concessions in the value given to the property are a market abuse that spells disaster for the unwary veteran, and other homebuyers and the taxpayer.

(3) Inadequate Loan Underwriting and Servicing - The VA and the MICs are obviously concerned that lenders employ sound credit underwriting practices in approving loans to ensure that the borrower has a reasonable ability to repay the loan. There is no advantage to the borrower or to the insurer if loan underwriting does not relate to this ability to repay. In this regard insurers are on the same side of the transaction as the borrower.

Lenders have traditionally described the application of VA underwriting criteria to be less stringent than that of MICs. The approach used by the VA of qualifying borrowers by funds available for support is different from the housing expense-to-income ratios used by MICs. Both methods can be equally valid if their key goal helps prevent the borrower from getting into an overobligated position. A default by the borrower can create a serious hardship for a family so an insurer should be concerned that the lender does a reasonable underwriting job from the borrower's perspective.

MICs have found that the coinsurance principle which tells lenders that in the event of a foreclosure they may retain along with title the responsibility to maintain and sell the property, has help to keep insurer losses down. We believe that the VA should make economic decisions on each foreclosed loan as to property disposition after claim and their policy should be based upon market conditions. Traditionally MICs have taken title and disposed of properties in about one-third of their claims. In recent years, this percentage has fallen well below one in fifteen claims. Claim mitigation by taking title is rare for MICs yet this option does impose a necessary discipline upon the lender's underwriting. Today, there appears to be greater pressure many lenders to originate higher volumes of loans to generate fees. This coinsurance helps lenders and investors to properly perceive the risk from poor underwriting.

Because of the trend for an increasing number of lenders to not make loans for their own accounts but for sale to investors, there is not only some increased likelihood for lax credit underwriting but of poor servicing. The selling of loan servicing has become more important in recent years because as loans go into default or foreclosure they require increased attention. As more loans become delinquent the cost of servicing goes up and often the quality of servicing goes down. Good loan servicers know it is not in their best interest to underwrite or acquire loans that are likely to create servicing problems. MICs have found that the overall quality of loan servicing can deteriorate exponentially when a large number of new loans have been acquired. This is especially true when the rersources the lender has availablee for counseling are very limited. The VA should monitor the track record of loans where servicing is sold.

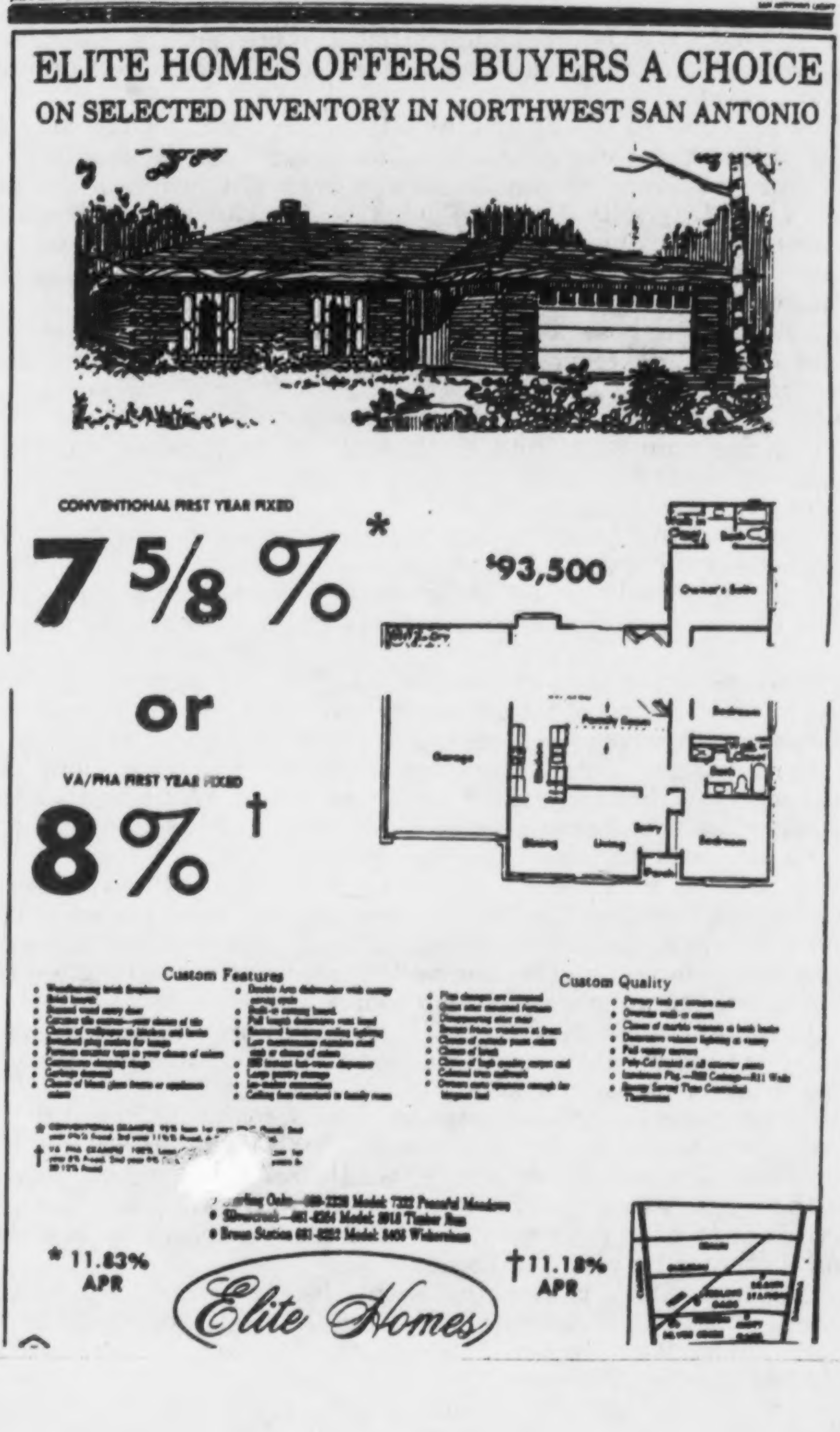
In the last several years, as noted earlier, MICs have seen a trend toward separation of the servicing function from the origination function. This tends to both lessen the accountability of the lender originating the loan and weaken the servicing by making counseling and other borrower assistance less readily available. Servicing is an important variable in default and foreclosure rates and MICs are developing special programs using the advice and guidance of good mortgage servicers to address problems A key step is to initiate counseling immediately when the borrower first has payment problems. To insure the benefit of the vetean is not reduced because of the poor servicing and loan counseling by a small number of lenders, new requirements may be needed to establish minimum performance of servicing to be eligible to file a claim.

In conclusion, MICA has never been invited for any dialogue with the VA so we have not had the opportunity to evaluate the VA's operations in any meaningful way. Because of all the changes in market practices facing insurers of residential mortgages, we would welcome such a dialogue since it would surely offer some mutual understanding and possible strategies for action.

Default losses have been high in the last several years following the recent economic downturn. The market changes that have been described have put pressures on MICs that are not likely to ease in the near term. If sound risk management practices are not employed including underwriting based upon good appraisals and reasonable borrower financing techniques, there are likely to be serious financial consequences. The VA home loan guaranty program was designed by Congress to benefit veterans and any contribution MICA can make to see government resources are used effectively to this end will be undertaken.

We appreciate the opportunity to present these comments.

San Antonio February 3, 1985



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$93,500

or

VA/FHA FIRST YEAR FIXED

8% †

Owner's Suite
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Family Room
Kitchen
Bedroom
Bath
Dining
Living
Entry
Bedroom
Porch

Custom Features

Custom Quality

- [illegible] Oaks—[illegible]-2228 Model: 7322 Peaceful Meadows
- Silvercreek—681-8264 Model: 8918 Timber Run
- Braun Station 681-8282 Model: 8403 Wickersham

* 11.83% APR

† 11.18% APR

Elite Homes

Mr. Principi. Mr. Wynn.

Mr. Wynn. Counselor, I'm president of Colonial Mortgage Co. of Montgomery, AL, and I'm honored to be recognized as the president of MBA, but I must admit that I represent the Mortgage Bankers Association as vice chairman of the Legislative Committee, not president.

MBA appreciates the opportunity to appear before you today to testify on the Veterans' Administration Home Loan Guaranty Program. Under current circumstances any oversight review of the VA Home Loan Guaranty Program must begin with a consideration and a rejection of the increase in guarantee fee as proposed by the administration and as partially accepted by the Senate Budget Committee.

In voting to impose an increase in the VA guarantee fee the Budget Committee reversed its earlier decision to reject the proposed increase.

MBA urges the Senate to reject the proposed increase.

During his campaign, and as recently as last week, President Reagan said that he would not increase taxes. With this proposed fee increase he contradicts himself.

The proposed fee is not only a tax on veterans seeking to own a home, but it's contrary to the whole purpose of the VA Home Loan Program. Apparently deficit reduction was not the only priority of those who designed the administration's fiscal 1986 budget proposal.

The proposed fee is more than a tax. It is an indirect effort to undercut the decision of Congress, reviewed and revised as recently as last year, to recognize veterans' service by helping veterans to own their homes. If additional taxes are needed they should be broad-based and not targeted to veterans. The MBA urges that the administration's proposed 5-percent increase and the Budget Committee's proposed 3.8 percent fee be rejected.

MBA believes that the VA Home Loan Guaranty Program is an excellent one and that the VA has operated the program well. The current VA projection that it might need appropriated funds to carry on the Home Loan Guaranty Program has caused a close examination of the program to be appropriate.

The program is not perfect, and it can be improved. But, the performance of the program confirms that it is being operated consistent with the mortgage markets.

MBA has recently created a special task force of mortgage bankers who are active in funding loans for veterans using the VA Home Loan Guaranty Program. This task force is working jointly with the VA to assist the VA in adapting the Home Loan Guaranty Program to current economic conditions of a relatively low rate of inflation of sales prices of homes.

In addition, MBA is working with The American Legion, the Vietnam Veterans of America and other veterans organizations to explore adjustments in the Home Loan Guaranty Program that would improve its efficiency.

We are hopeful that these joint efforts, along with the passage through the system of the adverse effects of the underwriting in the early 1980's will result in a healthy and effective VA Home

Loan Guaranty Program in the foreseeable future to serve the veterans of Vietnam and other years.

There are some adjustments that we believe should be made to the Home Loan Guaranty Program. The VA should be authorized to guarantee adjustable rate mortgages with such limits, if any, as the Administrator deems necessary. The program should accept mortgage interest rates that are negotiated between the borrower and lender, and not limited to interest rates that are administratively set.

And, with respect to vendee loans, the administration should be free to make the best deal possible when selling homes acquired by the VA in the program. However, setting quotas to increase the number of cases in which the VA refuses to acquire title to property after default is not a favorable adjustment.

Mortgage bankers are proud of the fact that they have participated in making a program work that has helped 11.5 million American veterans become homeowners. We appreciate the concerns of the committee that the program continue to be operated in the most efficient way possible and would be pleased to answer questions and respond to issues as the committee desires.

Mr. PRINCIPI. Thank you, Mr. Wynn.

[The prepared statement of Ronnie J. Wynn, president of Colonial Mortgage Co., Montgomery, AL, and vice chairman of the Legislative Committee of the Mortgage Bankers Association, Washington, DC, follows:]

PREPARED STATEMENT OF RONNIE J. WYNN, PRESIDENT OF COLONIAL MORTGAGE COMPANY, MONTGOMERY, AL, AND VICE CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE MORTGAGE BANKERS ASSOCIATION, WASHINGTON, DC

Mr. Chairman and members of the Committee, my name is Ronnie J. Wynn. I am President of Colonial Mortgage Company of Montgomery, Alabama. I am also Vice Chairman of the Legislative Committee of the The Mortgage Bankers Association of America.* Accompanying me are Burton C. Wood, MBA's Legislative Counsel, and William E. Cumberland, MBA's General Counsel.

MBA appreciates the opportunity to appear before you today to testify on the Veterans Administration (VA) home loan guaranty program. This is our first appearance since you have become Chairman, Senator Murkowski, and we would like to offer our congratulations and our appreciation that you have undertaken the leadership of this important Committee. We look forward to working with you and the Committee.

Under current circumstances, any oversight review of the VA home loan guaranty program must begin with a consideration and a rejection of the increase in origination fee as proposed by the Administration and as partially accepted by the Senate Budget Committee. In voting to impose an increase in the VA guaranty fee, the Budget Committee reversed its earlier decision to reject the proposed increase. MBA urges the Senate to return to the original position of the Budget Committee.

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry-related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance Companies
- Life Insurance Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

MBA headquarters is located at 1125 15th Street, N.W., Washington, D.C. 20005; telephone: (202) 861-6500.

During his campaign, and as recently as last week, President Reagan said that he would not increase taxes. With this proposed fee increase, he contradicts himself. The proposed fee is not only a tax on veterans seeking to own a home, but is contrary to the whole purpose of the VA home loan program. Deficit reduction was not the overriding priority of those who designed the Administration's FY 1986 Budget proposal. The proposed fee is more than a tax, it is an indirect effort to undercut the decision of Congress, reviewed and revised as recently as last year, to recognize veterans' service by helping veterans to own their homes. If additional taxes are needed, they should be broad-based and not targeted to veterans. MBA urges that the Administration's proposed five percent fee and the Budget Committee's proposed 3.8 percent fee be rejected.

MBA believes that the VA home loan guaranty program is an excellent one and that the VA has operated the program well. The current VA projection that it might need appropriated funds to carry on the home loan guaranty program has caused a close examination of the program to be appropriate. The program is not perfect, and it can be improved, but the performance of the program confirms that it is being operated consistent with the mortgage markets.

MBA has recently created a special task force of mortgage bankers who are active in providing private capital to fund the VA home loan guaranty program. This task force is working jointly with the VA to assist the VA in adapting the home loan guaranty program to current economic conditions of a relatively low rate of inflation of sales prices for homes.

In addition, MBA is cooperating with the American Legion, the Vietnam Veterans of America, and other veterans' organizations to explore adjustments in the home loan guaranty program that would improve its efficiency.

We are hopeful that these joint efforts, along with the passage through the system of the adverse effects of underwriting in the early 1980s, which can now be recognized as overly optimistic, will result in a healthy and effective VA home loan guaranty program in the forseeable future to serve the veterans of Vietnam and other eras.

There are some adjustments that we believe should be made to the home loan guaranty program. The VA should be authorized to guarantee adjustable rate mortgages (ARMs) with such limits, if any, as the Administrator deems necessary. The program should accept mortgage interest rates that are negotiated between borrower and lender, and not limited to interest rates that are administratively set. And, with respect to vendee loans, the Administration should be freed to make the best deal possible when selling properties acquired by the VA in the program. However, setting quotes to increase the number of cases in which the VA refuses to acquire title to property after default is not a favorable adjustment.

Mortgage bankers are proud of the fact that they have participated in making a program work that has helped 11.5 million American veterans become homeowners.

We appreciate your concern, Mr. Chairman and members of the Committee, that the program continue to be operated in the most effective way possible.

The Proposed Fee Is Not Designed to Strengthen the VA Home Loan Program

The President's FY 1986 Budget estimates that the VA will need $404.6 million in authorizations and appropriations to operate the VA home loan guaranty program. In connection with this estimate, the Budget proposes to change current law to impose a five percent loan origination fee on loans guaranteed by the VA, with the result that the need for guaranty program authorization and appropriations would be avoided. MBA understands that the Congressional Budget Office (CBO) estimates that the $404.6 million would not be needed, but the Administration's Budget proposal, which was partially accepted by the Senate Budget Committee, is based on the VA, not the CBO, estimate.

The linkage of the VA's need for funds to operate the guaranty program and the proposal to assess a five percent fee on the users of the program falsely implies that the proposed fee is designed to cover the costs of the program. Indeed, the Administration has even said that the fee request "clearly reflects the Administration's policy to require those receiving federal loan guarantees to pay for part or all of the expected federal default liability on guaranteed loans." (Testimony of the Administrator of Veterans Affairs before the House and Senate Veterans' Affairs Committees, February 20, 1985.)

Examination of the amount that the five percent fee will raise in relation to the needs of the VA loan guaranty program and examination of the context in which the fee is proposed reveal that the fee is intended to raise revenues generally, and was not designed solely to cover the costs of the home loan guaranty program.

Amount of the Fee Suggests a Reason Other Than Covering Costs

If the fee were designed to cover the costs of the home loan guaranty program, the amount that the fee would generate should bear a reasonably close relationship to the amount the program can be anticipated to need. The proposed fee bears no such close relationship. The Administration estimates that $404.6 million will be needed in FY 1986 to cover FY 1986 losses and expenses. We want to make two points. First, we estimate that the proposed fee will raise $597 million. This is far more than is needed—indeed it is 48 percent more—for this one year of operations. Second, and more important, assessing fees on new loans for one year's losses (on old loans) simply does not reflect a sound business approach to analyzing suitable fee levels. (See Exhibit 1.)

The Fee is Part of a General Revenue Raising Plan

The proposed five percent user fee for the VA home loan guaranty program is part of a government-wide five percent user fee proposal that would apply to the non-subsidized loan insurance programs of the Federal Housing Administration (FHA) as well as the VA program. With regard to the proposed five percent fee as it applies to the FHA programs, there can be no doubt that the purpose of the five percent fee is not to cover costs, because the non-subsidized FHA programs already cover all costs with a much lower fee. Since the 1950s, the FHA mortgage insurance premiums have supported the FHA non-subsidized insurance programs without requiring Congressional appropriations. Those premiums traditionally were collected at a rate of one-half of one percent annually over the life of the insured mortgage, and in the last two years have been collected as a one-time up-front premium of 3.8 percent. There can be no doubt that for the FHA program, the five percent fee will serve only the function of raising revenue generally. While there might be some ambiguity about the aim of a five percent user fee if it were only proposed for the VA program, in the context of the broader proposed application, the design of the five percent fee to raise revenues generally is revealed. Collection of money from the public, or some segment of it, for the purpose of raising revenue generally is a tax.

Absence of Rebate Provision Further Indicates That Revenue Raising Is the Aim of the Fee

The Administration's proposal makes no provision for returning a portion of the five percent guaranty fee to veterans who pay mortgages off early to reflect that the full term of the guaranty was not used. In the FHA mortgage insurance program, a portion of the insurance premium collected upon loan origination is refunded for mortgages that are prepaid. The concept of the FHA program is that the fee paid by the user is related to the cost of the service provided, and a borrower who uses the FHA insurance only for a relatively short time should not be required to pay the full fare. The budget proposal does not indicate that a rebate or a credit toward the fee for a refinance or restoration mortgage was even considered. The absence of consideration of a rebate provision indicates that the Administration's proposal was developed not with the costs of the services provided to the user in mind, but simply with a desire to raise revenues.

If Increased Taxes Are Needed to Reduce the Deficit, They Should Not Be Targeted to Homebuying Veterans

It may well be that new taxes will be necessary to allow the Government to reduce the Federal budget deficit in FY 1986, but those taxes should be broad-based and should be decided upon in an open discussion of tax policy. The five percent user fee proposal is a back-door levy on homebuying veterans, thinly disguised as a cost-related user fee intended to strengthen the program.

The five percent fee proposed by the Administration would be a significant increase in tax for the homebuying veteran. For example, the VA has estimated that the fee would add $30 per month to the payments required to carry the average VA mortgage. The amount of the average mortgage guaranteed by the VA in 1984 was $64,000, according to the VA. A veteran whose income just qualifies for the $64,000 mortgage would be earning approximately $21,600, according to typical mortgage underwriting criteria. Internal Revenue Service statistics (Individual Income Tax Returns, 1982 Statistics of Income) show that taxpayers earning $21,600 paid, on average, a Federal income tax of $2,500 in 1982 (the latest year for which figures are available). The proposed fee would increase that average veteran's tax by $360, or 14 percent per year if, as will likely happen in most cases, the fee is added to the mortgage. If the veteran pays in full in cash, the tax would be $2,560 in the year of the guaranty, over double the average tax! The President may have promised no additional taxes during his campaign, but, for the veteran obtaining a VA home loan guaranty, the President is proposing a substantial tax increase.

The 3.8 percent fee proposed by the Senate Budget Committee would also be a significant increase in the tax for the homebuying veteran. If the fee were added to the average mortgage, the tax would increase by $228 or nine percent per year. If paid in cash, the tax would be $1,792.

The Fee Would Increase Borrowing Costs to Veterans

The VA has indicated that veterans would be allowed to add the origination fee into the principal balance of the loan. Using this approach, the full five percent fee would be paid by the lender to the VA at the time the mortgage was originated, and the veteran would pay back this advance, with interest, over the life of the loan. Based on historical data furnished by the Loan Guaranty Department of the VA, MBA has calculated the amount of the average VA-guaranteed mortgage in 1984 to be $64,000, on which the proposed additional fee would be $2,560. For the average VA mortgage in 1984 of $64,000, the extra payments, over the full 30-year term for which VA-guaranteed mortgages typically are written, would amount to extra payments totalling approximately $11,000. This extra cost to the borrower of the average mortgage amount is an arithmetical calculation based upon an interest rate of 12.5 percent, which was the administratively allowed rate when the Administration's proposal was made.

The statistics would be revised downward if the 3.8 percent fee were imposed as proposed by the Senate Budget Committee, but the principals would remain the same. The additional fee would be $1,800 or, if amortized, $6,800 over the life of the loan.

There is another way of expressing the cost to veterans of imposing the five percent fee. Again using the average 1984 VA-guaranteed mortgage of $64,000, the minimum family income needed to qualify for the average mortgage, using typical underwriting standards, today would be $21,600. If the full five percent fee were imposed, and the necessary monthly payment increase recognized, the required minimum income would have to be $22,600, even though the monthly payment would increase only an estimated $30.00.

The importance of this difference is realized in the fact that most VA guaranteed loans are no-downpayment loans; that is, the amount of the loan is the price of the house. Thus, where without the imposition of the proposed five percent fee, veterans with incomes of $21,600 and above could afford the house financed by the $64,000 mortgage; with the fee, only veterans with incomes of $22,600 and above could afford it. Based on the most recent census statistical distribution of veterans' income, approximately 850,000 veterans would thus be precluded statistically from buying the house now financed with the average 1984 VA-guaranteed loan. (Veterans in the United States, A Statistical Portrait from the 1980 Census, VA, October 1984.) Of course, the Senate Budget Committee proposed increase to 3.8 percent would have a lesser, but still dramatic, impact of statistically excluding 510,000 veterans.

Averages are not the only way to understand the adverse impact upon the cost to veterans that adoption of the proposed five percent fee would have. In fact, the hardest hit veterans would be those in the lower income ranges. The VA has a procedure whereby marginal cases are specially reviewed prior to being approved. Marginal cases are those where the veteran is stretching to buy a home. In calendar year 1984, approximately 60 percent of VA's marginal prior approval cases were for mortgages below the average mortgage. The impact of the increased cost of the five percent fee will affect most severely those borrowers who are on the margin and who are struggling to achieve homeownership by the use of the VA program.

The Fee Would Threaten No-Downpayment

The VA has indicated that it will allow veterans to pay the proposed five percent guaranty fee direct to the VA in cash, or allow lenders to advance the fee on the veteran's behalf and add the advance onto the original balance of the loan. If such inclusion in the loan is not fully and continually allowed, the effect is the same as requiring a downpayment of five percent. There could be pressures not to allow the fee to be added onto a no-downpayment loan, because the addition could make the total housing debt of the veteran more than the house is worth. How strong these pressures will be will reflect the extra program costs caused by foreclosure losses and by veterans who lose motivation to try to preserve a negative value asset.

The Fee is a Transfer of Burden

In proposing that homebuying veterans should increase their mortgage debt by the amount of the proposed additional origination fee, the Administration is asking veterans to shoulder the burden of expenses brought about by other veterans who entered the home loan guaranty program earlier. This is another reflection that the proposed fee is not user-cost related. Moreover, it shows a willingness of the Administration to transfer the burden of general government obligations, entered into willingly in the past, to a specific, targeted group of taxpayers who are not specifically benefitting from those obligations.

The Fee is Contrary to a Commitment to Veterans

When Congress created the VA home loan guaranty program in 1944 to assist veterans returning from World War II to buy a home, Congress did not design it or intend it to be user-fee supported. The program was a recognition by a grateful nation that the men and women who had forgone civilian life, many of them against their will, to defend the vital interests of the country should be aided in achieving a home. The program was partial payment for services performed.

To young men and women who entered military service in subsequent years, some of them against their will, to protect the vital interests of the nation in Korea, Vietnam, and elsewhere, the program became a commitment. That commitment has been reviewed from time to time, and Congress has always determined to renew it, the latest review being only last year.

From the beginning, there was a realization that the program would need appropriations, and appropriations have been made in several fiscal years during the operation of the program. In 1984, Congress was faced with the fact that the economic cycle and certain changes in other VA operations precluded the VA from funding the home loan guaranty program from internal VA sources, and that appropriations would be required to continue the program.

Last year, Congress considered whether to renew its commitment to qualified veterans, especially the Vietnam veterans who are now reaching the point in their lives when they are ready to buy a home. The requested authorization and appropriations were granted, the VA was directed to administer the program in certain ways to reduce costs, and a one percent temporary funding fee was set to expire September 30, 1987.

The effects on the program of the 1984 directives by Congress, of course, need to be studied, and the program may need further adjustments. But as recently as a year ago, Congress renewed its commitment to qualified veterans to assist them in buying a home, with a relatively nominal funding fee of one percent through 1987.

The Fee is an Indirect Attack on the Program

As discussed at length above, the proposed five percent fee is presented as a necessary way of covering costs, similar to the one percent fee adopted by Congress last year. While not embracing the one percent fee last year, MBA testified before the Veterans' Affairs Committee that the one percent temporary fee "is acceptable if a disruption of the program is the alternative." For the reasons set forth above, the five percent fee will disrupt the program; it is not an alternative to disruption. In its budget submission, the Administration did not raise or discuss this disruption. Only after questioning by some of the members of the Committee during hearings held on February 20, 1985, did the VA admit there would likely be disruptions of the program.

Beginning in 1981, the Reagan Administration has consistently demonstrated that it believes that the Government should discontinue the commitment to supporting the homeownership aspirations of Americans. In 1981, the Administration proposed a rollback and elimination of the Federal Housing Administration and the Government National Mortgage Association. Congress disagreed. Last year, the Administration proposed a scheme under which the VA would make lenders dispose of all properties after default, even after the Administration had been warned that such a drastic and retroactive change could wreck the program. Congress would not allow it.

This year, the Administration has recalled the political theory tenet that "the power to tax is the power to destroy." By proposing a five percent tax on the users of the VA home loan guaranty program, the Administration has taken a first step toward accomplishing indirectly what it cannot achieve directly: a diminution and even a phasing out of the VA home loan guaranty program.

MBA strongly urges that this Committee and the Congress reject the proposed increase in guaranty fee for the VA home loan program.

Operation of the VA Home Loan Guaranty Program

The VA home loan guaranty program is an entitlement program established under the Serviceman's Readjustment Act of 1944. The program's purpose is to assist qualified veterans to achieve homeownership. The program provides two primary benefits to qualified veterans. First, the VA guarantees a portion of the veteran's mortgage principal. The amount of this guaranty has varied over the years and is now 60 percent of the loan amount, up to a maximum of $27,500. With this gueranty available, mortgage lenders are able to provide veterans purchasing homes with financing at a lower rate than is available when the program is not available. The second benefit offered by the program is the stipulation that no downpayment need be required by the lender. A loan with no downpayment is a "100 percent loan" because the loan amount is 100 percent of the value of the property. On an annual basis from 1977 to 1984, between 58 percent and 70 percent of VA-guaranteed loans closed were 100 percent loans. (See Exhibit 2.)

Since the VA initiated its program in 1944 until the end of 1984, 11.5 million loans have been guaranteed under the VA home loan guaranty program. The vast majority of those loans have cost taxpayers only the administrative cost of processing the initial approval.

Only four percent of those loans have resulted in foreclosure. The foreclosure rate for VA-guaranteed loans has increased somewhat in the past two years following the severe recession that gripped the U.S. economy and the historically high unemployment rates that resulted (Exhibit 3 and Exhibit 4).

The budgetary mechanism for the Loan Guaranty Program is the Loan Guaranty Revolving Fund (LGRF). The fund was established to balance the income and expenses caused by the operation of the program. Income for the fund is derived primarily through the sale of "vendee" loans. Vendee loans are loans made by the VA to a borrower when a VA-acquired property is sold. Expenses accrued by the LGRF are predominantly from the acquisition of foreclosed properties.

Historically, when the LGRF was in a deficit position, the VA transferred money from its Direct Loan Revolving Fund (DLRF). The DLRF exists as a result of a former VA policy to make direct loans to veterans who live in credit-short areas and can find no other lender to make a VA-guaranteed loan. In such instances the VA acted as a lender and the earnings on the direct loans provided the VA with a surplus in the DLRF.

Three years ago, the VA was instructed by the Administration to make no more direct loans. Consequently, the net earnings of the DLRF is diminishing. Thus, at a time when the LGRF is experiencing great cash demands due to the recent recession and ensuing increased foreclosures, the DLRF is in its most illiquid position.

The VA Home Loan Program Has Performed Consistently With The Market

A dramatic consequence of the reduction of the DLRF's ability to provide funding for the LGRF has been to make it appear that the loan guaranty program is experiencing losses beyond expectations and beyond comparable mortgage programs. In fact, the change in the VA home loan guaranty program foreclosure and claim rate actually has been better, relatively, than the increase in foreclosures of conventional loans, which are loans that are not insured or guaranteed by the government (Exhibit 5). And compared with the FHA, while VA guaranteed loans have had a higher foreclosure rate than FHA-insured mortgages since the mid 1970s, the relative relationship has remained substantially constant (Exhibit 6). These relative relationships suggest that the VA program is inherently sound and being operated consistent with the mortgage programs of the FHA and conventional lenders.

Restorations

The only significant aberration that MBA has noted in the recent foreclosure statistics of the VA home loan guaranty program are those for restoration loans. Restoration loans are those guaranteed by the VA pursuant to a restoration of entitlement to a veteran who has paid off (or had another eligible veteran assume) an earlier loan guaranteed by the VA.

While the proportion of VA guaranteed restoration loans remained substantially constant from 1978 to 1983 at 11 percent of loans guaranteed, the proportion of claims for restoration loans has risen steadily from 1.3 percent of total claims to 7.9 percent from 1978 to 1984 (Exhibit 7 and Exhibit 8). The information available does not yet provide an explanation of this disproportionate increase, but further study is suggested.

Improvements Can Be Made

At the suggestion of the VA Administrator, Harry Walters, MBA has created a special ad hoc task force to work in cooperation with the VA to make recommendations to the VA for improvements to the program to reduce losses. The task force held its initital meeting on March 12, 1985. From that meeting, several suggestions have already emerged. One suggestion is that a copy of the appraisal of the house that will secure the VA guaranteed loan be furnished to the lender. Currently, the lender receives only a CRV (Certificate of Reasonable Value), which does not set forth the steps of the analysis made by the VA selected appraiser. This proposal would allow lenders to review the procedures followed by appraisers in each case. Another suggestion is that the VA should systematically monitor the appraisers who evaluated properties involved in subsequent foreclosures, to ascertain whether certain appraisers have a disproportionate inaccuracy rate, and should be removed from the VA-approved appraiser panel.

Other suggestions include an expedited review by the VA of offers of deed-in-lieu of foreclosure in order to prevent unpaid interest running while these cases are under study and an agreement by the VA not to charge lenders for interest that accrues during a formal forebearance agreement. Under this last proposal, if a lender allows a veteran to remain in the home while stretching out payments, the unpaid interest will not be permitted to cause the case to become a "no bid" case, in which the lender would be required to accept a payment of the claim and dispose of the property because the accumulated unpaid interest had made the case one where the VA would economically be better off not accepting title to the property.

Increased Refusal to Accept Title to Property is Not Helpful

In its FY 1985 Budget proposal, the Administration proposed that the VA should pay in full the claims under the VA home loan guaranty program, and leave with the lender the responsibility of disposing of the property securing the guaranteed loan. This recommendation, while rejected by Congress, has not been acknowledged as abandoned by the

Administration, and so, must be addressed. The recommendation apparently rested on the assumption that, if the VA ceases to acquire foreclosed properties, there will be an enormous apparent cost savings to the government.

The VA will not save money by paying the lender the guaranty amount in all foreclosure cases. When the past experience of the VA is examined, it is clear that, since 1979, the average loss on properties acquired and subsequently sold is about $10,000 less than if the VA had paid the average guaranty on those properties (Exhibit 9). The proposed change would cause a greater drain on VA finances than the current policy because VA's cash inflow will be diminished once the current inventory of properties is liquidated.

Effect on Lenders and Veterans

The change in the VA guaranty settlement policy not yet abandoned by the Administration affects both VA lenders and veterans themselves.

As a group, mortgage bankers make about three-quarters of all VA-guaranteed loans, more than any other category of lenders (Exhibit 10). Thus, mortgage bankers would be affected more than other lenders by the change in VA policy. The impact will affect certain aspects of a lender's business, as well as the lender's perception of the risk potential of a VA-guaranteed loan.

One of the major assumptions made by the Administration is that, if the VA does not acquire a property by entering a bid to do so, there will be a third party who will acquire the property from the lender. By making this assumption, the Administration sidesteps the issue of a lender being left holding title to property. The assumption that a third party buyer would come forward assumes a perfect market. There may be a prospective buyer in the market for the foreclosed property at a price near or below what the VA would have bid. The problem is that foreclosure sales require ready cash and information not available to most buyers.

A more realistic scenario is that, if the VA enters no bid, in only a small percentage of cases will a third party take title to the property. The majority of foreclosures will result in the lender taking title to the property and being responsible for maintenance, renovation, marketing, and eventual sale of the property.

The vast majority of lenders, especially small mortgage bankers, are not capitalized to deal with property disposition. In order to complete the transfer quickly and efficiently, lenders would be forced either to develop property disposition centers or turn to others who, for a fee, would handle the property disposition. Either approach would put lenders, especially the smaller ones, under great financial strain. Needless to say, it would also make VA-guaranteed loans less attractive to lenders and increase the cost of mortgage credit to veteran borrowers. Vietnam era veterans, who are still entering the housing markets as first-time homebuyers, would perhaps be particularly hard hit by this proposed change.

VA-guaranteed loans would likely be perceived as carrying a much larger share of risk to lenders in the mortgage markets. Lenders would then begin to apply more stringent underwriting procedures to applications of prospective VA borrowers, and a higher yield would be required in the market to compensate investors for the additional risk they are accepting by purchasing a VA-guaranteed loan.

By continuing to pursue this policy change, the Administration would be creating an atmosphere in which veterans with VA-guaranteed loans will be second class citizens.

VENDEE LOANS

The President's budget for FY 1985 indicated that the VA would discontinue selling vendee loans with recourse. MBA opposed that proposed change in current practice. Sale of vendee loans without recourse shifts the credit risk of default from the VA to private purchasers, and purchasers necessarily adjust their purchase prices accordingly. Because of its size, and because it is the lender, the Government is a more efficient manager of vendee loan credit risk than any private buyer can be. Therefore, it can be expected that the reduction in the sales price paid by the private industry buyers of vendee loans will be greater than the savings the Government might realize by transferring the risk of default. In the Deficit Reduction Act of 1984 (PL 98-369), a target of the proportion vendee loans was set for the VA. MBA urges that the quota concept be removed, and that the VA be allowed to use guaranteed vendee loans as fully as it deems economically advantageous in selling property acquired in the home loan guaranty program.

INCREASE IN GUARANTY MAXIMUM

MBA supports the proposal included in S 9, a bill introduced by Senator Robert Byrd on behalf of Senator Alan Cranston, to increase the maximum amount of the VA loan guaranty from $27,500 to $35,000 for home loans and from $20,000 to $22,000 for manufactured housing loans. Such an increase would bring the relationship between the level of the guaranty amount and the ever increasing cost of new and existing housing closer to historical ratios.

From 1974 to 1984, the median price of new single-family homes sold jumped from $35,900 to $79,900, an increase of 123 percent. Had the VA maximum guaranty been adjusted annually in equal proportion to the increase in new home prices, the 1984 guaranty would have reached $39,000 (Exhibit 11 and Exhibit 12).

The median price of existing single-family homes sold increased over 120 percent during the period 1974 through 1984, from $32,000 in 1974 to $72,800 in 1984. Adjusting the VA maximum guaranty for annual increases in existing home prices for this period would have resulted in a maximum guaranty of over $39,800 in 1984 (Exhibit 11 and Exhibit 12).

FREE VA INTEREST RATE

Under current law, the maximum interest rate allowable on a mortgage guaranteed by the VA is fixed by the VA Administrator. MBA has consistently urged that the law be amended to allow interest rates to be determined by the market.

ADJUSTABLE RATE MORTGAGE

MBA urges that the VA be authorized to include adjustable rate mortgages (ARMs) in the home loan guaranty program. During the past three years, ARMs have become accepted by borrowers in the conventional mortgage market. FHA has expanded its insurance program to include ARMs. These markets have demonstrated that ARMs are a beneficial development that permits borrowers and lenders to tailor transactions to the needs of borrowers. Borrowers who do not want to pay for the predictability of a fixed rate mortgage can achieve the lower interest rates that lenders can offer when the borrower bears some of the risk of inflation or other economic conditions that cause rates generally to rise.

In his bill, S 9, Senator Cranston has proposed authorizing the VA to guarantee ARMs. To the extent that the measure would accomplish this purpose, MBA supports the bill. However, S 9 would limit the ability of borrowers and lenders to reach the best arrangement between them because adjustments in interest rates provided in VA guaranteed mortgages would be subject to four limits or "caps" enumerated in the bill.

MBA is opposed to statutory caps on ARMs. Adjustments should be freely negotiated, just as traditional long-term fixed rate mortgage interest rates should be. At the most, authority could be left with the Administrator of the VA to set caps for ARMs in the home loan program as the program and the veterans it benefits gain experience with ARMs.

Experience with the FHA insurance program caps of one percent per annum increase, which would be placed on VA ARMs by S 9, is that investors in the market are not attracted.

Whatever may have been the case previously, ARMs are no longer an untested and unknown quantity. Approximately 53 percent of new conventional mortgages originated in the last quarter of 1983 were ARMs, and the percentage has risen to 57 percent by the last quarter of 1984. (Federal Home Loan Bank Board "Conventional Home Mortgage Rates," February 4, 1985.)

Consolidation of Functions

In the President's FY 1986 Budget, the VA has announced its intention to consolidate and centralize at three sites over 1986-1988, "those functions that are performed without need for direct contact with veterans." These services are now performed at 59 regional offices. The Budget indicates that processing of applications for guarantees of home mortgages will be one of the functions to be consolidated.

A drastic consolidation of the VA loan guaranty offices will interfere with the way in which the VA home loan guaranty program has worked so well to the benefit of the veteran. The current VA program places great emphasis on personal contact between the mortgage lender, VA, and the veteran. For instance, during the loan application process, VA works closely with the lender to determine whether the veteran can qualify for the loan and whether the sales price accurately reflects the appraised value of the property. It is not uncommon to have numerous contacts between VA and the lender to solve problems relating to required documentation or other such problems that may arise during the application and appraisal process. Proximity between the VA and lender offices is an essential ingredient to the efficient flow of work and speed in processing loan applications. VA regulations also require a local fee appraiser to be appointed to determine the appraised value of the property prior to VA's granting a Certificate of Reasonable Value (CRV). It is extremely important for loan guaranty personnel to be familiar with local market conditions in order to analyze the appraisal report and underwrite the loan. Oftentimes, problems will occur in the appraisal or an appeal will be filed requiring a second appraisal on the property. Again, proximity to the property and appraiser will help the VA deal expeditiously and efficiently with the situation.

The Veterans' Administration also provides a supplemental servicing program whereby personnel from the loan guaranty office will personally visit veterans whose loans are in default, and provide counseling. This service, which is handled on a local level by loan guaranty personnel, saves VA a considerable amount of money in claims. This service would not be nearly as efficient if consolidation of offices removes the personal contact between the VA and the veteran. As is true of most financial transactions, time is money.

In a mortgage transaction, the borrower may suffer as much as the lender in the event of processing delays. In periods of volatile markets, which seem to have become the normal business environment, frequent yield shifts between the time the veteran makes an application for a loan and the time in which a loan is closed expose the veteran to the possibilities of increased interest rates. If, during that period, market conditions require the VA to increase the maximum allowable interest rate, the veteran's application that is in process will be assigned the higher interest rate. Obviously, the longer the processing time, the greater the exposure to market fluctuations and increased rates.

Section 601(B) of the "Veterans' Disability Compensation, Housing, and Memorial Benefits Amendments of 1981" (PL 97-66) requires the VA to submit to "the appropriate committees of Congress a report containing a detailed plan and justification" for an administrative reorganization such as is noted in the President's Budget. This legislation was enacted in response to a 1981 proposal to consolidate the 59 VA regional offices into three.

In 1981, MBA acknowledged that the workload in some regional offices may not be great enough to justify a fully staffed loan processing and claims operation. We supported the requirement that a study be conducted of the workload of each VA field office to determine which offices could be consolidated with as little impact as possible on VA's capability to administer the loan guaranty program properly. To date that study has not been furnished to Congress. The VA should not be allowed to carry out its proposed consolidation until the detailed plan and justification has been timely submitted to Congress with an opportunity for its review.

We appreciate the opportunity to appear before the Committee, and we would be pleased to furnish any additional information that may be needed.

Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 1

ANALYSIS OF PROPOSED FOUR PERCENT INCREASE IN VA FUNDING FEE

Line 1.	Projected Amount of VA Loans Closed, FY 1986, From VA Budget	$14,933,000,000
Line 2.	Additional Fee Income Generated, FY 1986, MBA Calculation (Line 1, times 4% additional fee)	$ 597,320,000
Line 3.	Projected Income Requied For Solvency, FY 1986, From VA Budget	$ 404,600,000
Line 4.	Amount of Overage, FY 1986, MBA Calculation (Line 2 minus Line 3)	$ 192,720,000
Line 5.	Overage as a Percent of Required Income, FY 1986, MBA Calculation (Line 4 divided by Line 3)	48

Sources: Veterans Administration; Mortgage Bankers Association of America, April 1985.

Prepared by Mortgage Bankers Association of America, Economics Department, April 1985.

Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 2

VA HOME LOAN GUARANTY PROGRAM ACTIVITY
PRIMARY HOME LOANS CLOSED

Total [1]

	Number	Loan Amount ($Mil)	Average Loan Amount	Average Purchase Price	Avg. Loan to Value Ratio
1977	371,610	13,260	$35,683	$36,982	96.5
1978	352,797	13,959	$39,567	$41,079	96.3
1979	345,708	15,991	$46,256	$48,555	95.3
1980	255,631	13,257	$51,860	$55,092	94.1
1981	136,027	7,543	$55,452	$58,833	94.3
1982	87,027	5,053	$58,062	$63,112	92.0
1983	227,155	14,092	$62,037	$66,723	93.0
1984	181,771	11,633	$63,998	$67,584	94.7

[1] Loans for refinancing not included.

100% Loans

	Number	Percent of Total Number	Loan Amount ($Mil)	Average Loan Amount
1977	259,509	69.83	8,817	$33,975
1978	244,458	69.29	9,091	$37,188
1979	234,810	67.92	10,260	$43,695
1980	169,839	66.44	8,195	$48,254
1981	89,758	65.99	4,569	$50,901
1982	50,285	57.78	2,629	$52,284
1983	137,315	60.45	7,868	$57,299
1984	118,218	65.04	7,042	$59,564

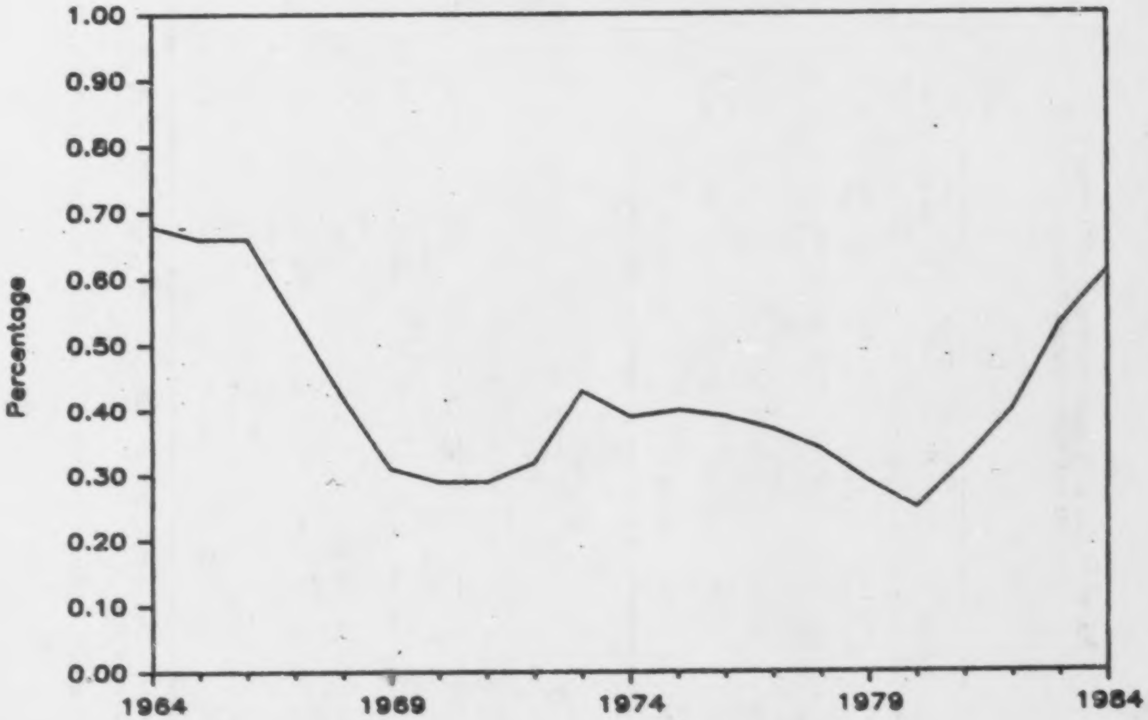
Source: Program Management Service, Loan Guaranty Department of the Veterans Administration.

Prepared by Mortgage Bankers Association of America, Economics Department, April 1985.

Chart to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, May 1, 1985

EXHIBIT 3

VA CLAIMS PAID DURING YEAR AS A PERCENT OF VA LOANS
OUTSTANDING END OF YEAR



Source: Veterans Administration, Loan Guaranty Department

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985

Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 4

FORECLOSURES STARTED
(Percent of Number of Loans Serviced)

	VA	FHA	CONVENTIONAL
1979	.70	.78	.25
1980	.70	.74	.31
1981	.72	.83	.42
1982	.92	1.07	.53
1983	.97	1.03	.63
1984	.95	1.03	.63

Source: National Delinquency Survey, Mortgage Bankers Association of America, February 1985.

FORECLOSURES COMPLETED
(Percent of Number of Loans Outstanding)

	VA 1/	FHA 2/	CONVENTIONAL 3/
1979	.30	.48	.09
1980	.25	.41	.12
1981	.32	.40	.18
1982	.40	.46	.33
1983	.53	.67	.41
1984	.61	.75	NA

Sources:
1/ Veterans Administration
2/ Federal Housing Administration
3/ Federal Home Loan Bank Board. Note: Includes all conventional mortgage loans.

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985.

Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 5

NUMBER OF FORECLOSURES STARTED DURING QUARTER AS A PERCENT OF NUMBER OF LOANS SERVICED FOR 1- TO 4-UNIT RESIDENTIAL MORTGAGE LOANS

Yr. Qtr.	VA	FHA	Conv.
1973.1	0.18	0.43	0.05
1973.2	0.19	0.41	0.05
1973.3	0.19	0.40	0.06
1973.4	0.18	0.40	0.07
1974.1	0.18	0.37	0.08
1974.2	0.17	0.38	0.06
1974.3	0.19	0.37	0.08
1974.4	0.20	0.38	0.09
1975.1	0.21	0.33	0.10
1975.2	0.23	0.34	0.10
1975.3	0.21	0.31	0.09
1975.4	0.19	0.26	0.09
1976.1	0.18	0.24	0.07
1976.2	0.19	0.20	0.08
1976.3	0.19	0.21	0.08
1976.4	0.20	0.24	0.09
1977.1	0.22	0.24	0.08
1977.2	0.21	0.23	0.08
1977.3	0.20	0.22	0.07
1977.4	0.19	0.20	0.07
1978.1	0.19	0.21	0.06
1978.2	0.18	0.22	0.06
1978.3	0.20	0.21	0.06
1978.4	0.20	0.22	0.07
1979.1	0.19	0.22	0.07
1979.2	0.17	0.19	0.06
1979.3	0.15	0.16	0.06
1979.4	0.19	0.21	0.06
1980.1	0.16	0.16	0.07
1980.2	0.17	0.18	0.07
1980.3	0.19	0.20	0.08
1980.4	0.19	0.21	0.09
1981.1	0.18	0.20	0.09
1981.2	0.19	0.22	0.10
1981.3	0.17	0.19	0.11
1981.4	0.19	0.21	0.11
1982.1	0.22	0.25	0.13
1982.2	0.22	0.25	0.12
1982.3	0.24	0.28	0.14
1982.4	0.24	0.29	0.14
1983.1	0.23	0.25	0.14
1983.2	0.26	0.28	0.16
1983.3	0.24	0.26	0.16
1983.4	0.24	0.24	0.17
1984.1	0.23	0.23	0.13
1984.2	0.24	0.25	0.16
1984.3	0.27	0.30	0.19
1984.4	0.21	0.25	0.15

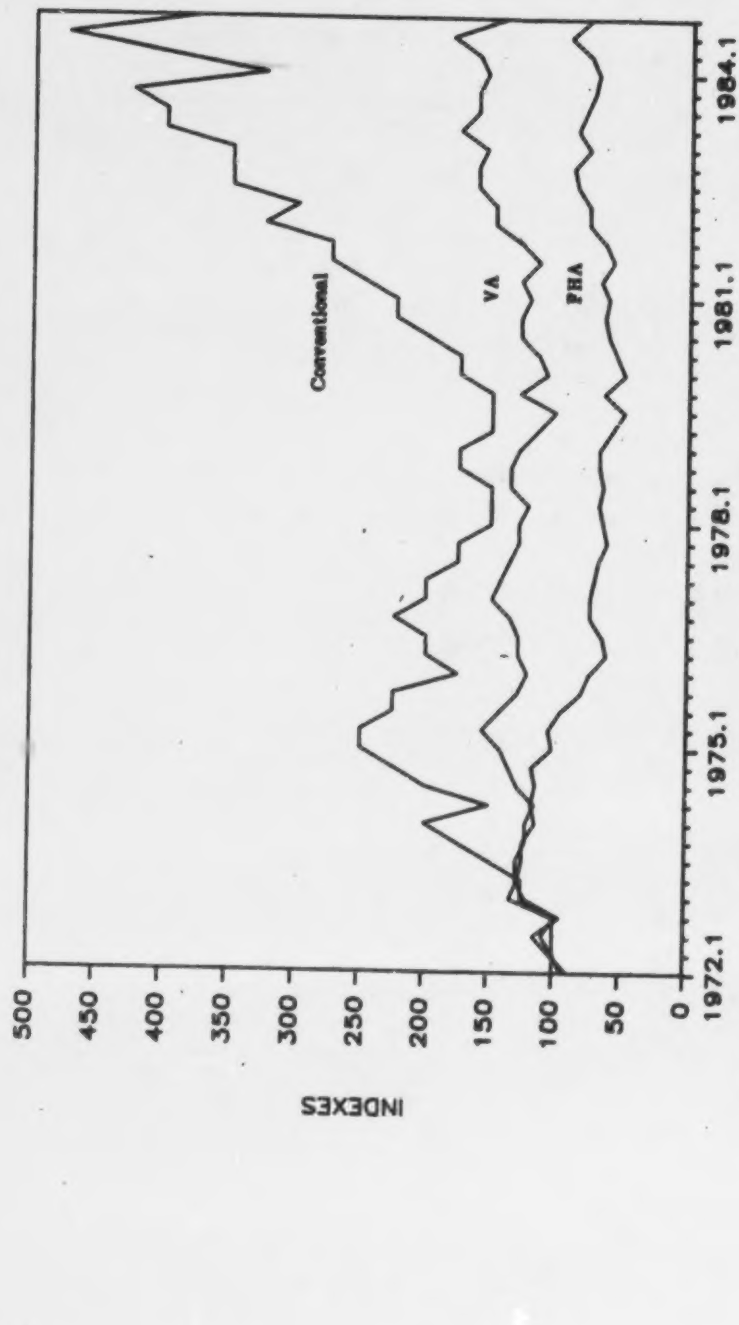
Source: National Delinquency Survey, Mortgage Bankers Association of America.

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985.

Chart to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, May 1, 1985

EXHIBIT 6

GROWTH IN FORECLOSURES STARTED
INDEXES (1972 = 100)



Source: National Delinquency Survey; Mortgage Bankers Association of America

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985

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Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 7

VA RESTORATION USE AND FORECLOSURES

	Restoration Use (Percent of Originations)	Restorations Foreclosures (Percent of All VA Foreclosures)
1978	10.3	1.3
1979	11.0	1.6
1980	11.2	2.9
1981	10.4	4.4
1982	10.1	6.6
1983	10.6	7.7
1984	15.1	7.9

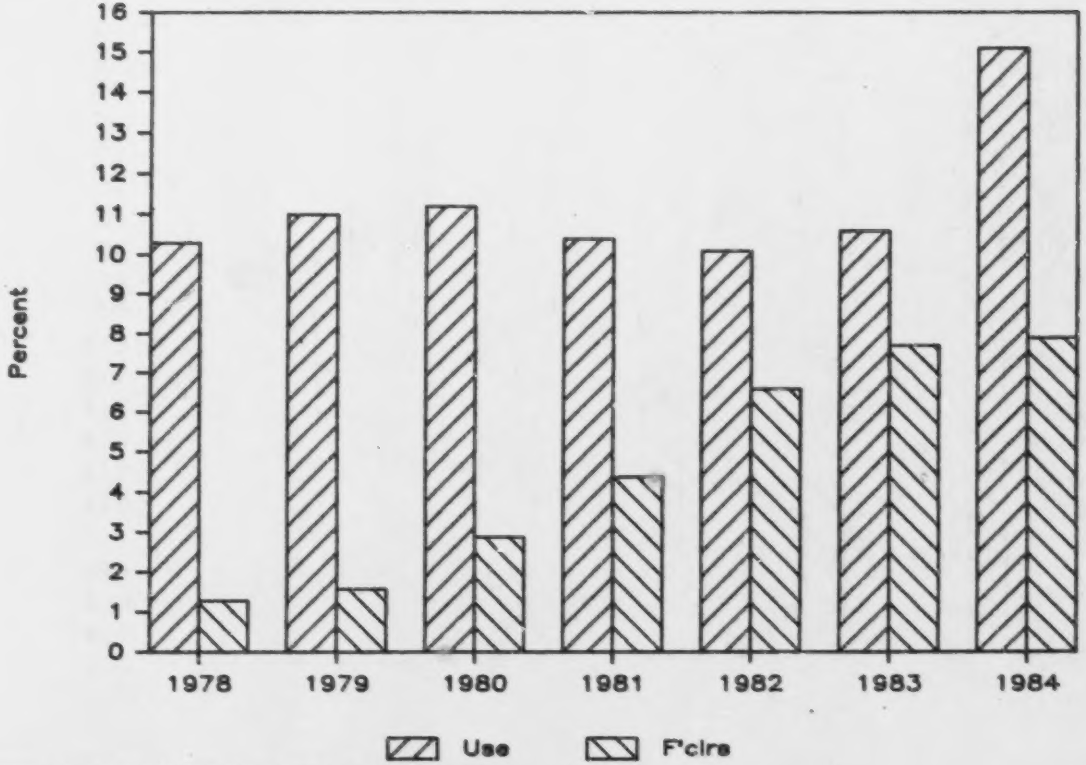
Source: Veterans Administration, Loan Guaranty Department

Prepared by the MBA Economics Department, April 1985.

Chart to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, May 1, 1985

EXHIBIT 8

VA RESTORATION USE AS A PERCENT OF VA ORIGINATIONS, AND RESTORATIONS FORECLOSED AS A PERCENT OF ALL VA FORECLOSURES



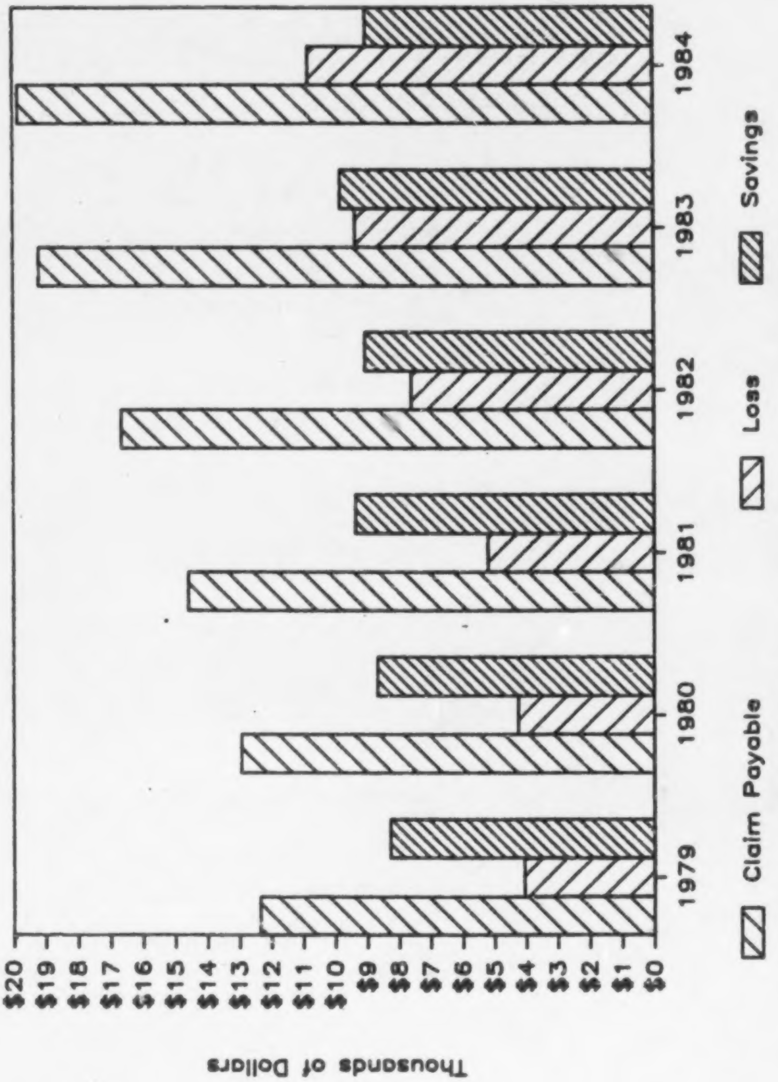
Source: Veterans Administration, Loan Guaranty Department

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985

Chart to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, May 1, 1985

EXHIBIT 9

AVERAGE VA CLAIM PAYABLE FOR PROPERTY SOLD DURING FISCAL YEAR;
AVERAGE LOSS FOR PROPERTY SOLD DURING FISCAL YEAR;
AVERAGE SAVINGS FROM SALE OF PROPERTY DURING FISCAL YEAR



Source: Veterans Administration, Loan Guaranty Department

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985

Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 10

MORTGAGE BANKERS ORIGINATIONS OF VA AND FHA LOANS AS A PERCENT OF TOTAL VA AND FHA ORIGINATIONS

		Mortgage Bankers Originations ($ millions)		Percent of Total Originations of:	
		VA	FHA	VA	FHA
1975		$ 6,326	$ 4,601	71.6%	73.4%
1976		7,381	5,096	70.8	72.8
1977		11,624	8,228	78.1	78.6
1978		12,372	11,587	77.2	79.5
1979		15,554	17,397	82.4	83.9
1980		9,567	12,161	79.1	81.3
1981		6,044	8,736	80.2	82.9
1982		6,158	9,808	80.1	85.4
1983		14,148	22,936	74.9	79.8
1984	QI	2,571	3,492	74.5	78.6
	QII	2,508	3,527	75.4	79.9
	QIII	1,504	2,123	69.9	76.2

Source: Survey of Mortgage Lending, Department of Housing and Urban Development.

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985.

Table to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, April 1985

EXHIBIT 11

	Maximum VA Guaranty		Median Sales Prices					
			Existing Homes		New Homes		All Homes 1/	
	Amount	% Change From 1974	Price	% Change From 1974	Price	% Change From 1974	Price	% Change From 1974
1974	$17,500	NA	$32,000	NA	$35,900	NA	$32,725	NA
1975	$17,500	0.0	$35,300	10.3	$39,300	9.5	$36,026	10.1
1976	$17,500	0.0	$38,100	19.1	$44,200	23.1	$39,162	19.7
1977	$17,500	0.0	$42,900	34.1	$48,800	35.9	$43,981	34.4
1978	$25,000	42.9	$48,700	52.2	$55,700	55.2	$49,891	52.5
1979	$25,000	42.9	$55,700	74.1	$62,900	75.2	$56,825	73.6
1980	$27,500	57.1	$62,200	94.4	$64,600	79.9	$62,572	91.2
1981	$27,500	57.1	$66,400	107.5	$68,900	91.9	$66,782	104.1
1982	$27,500	57.1	$67,800	111.9	$69,300	93.0	$68,057	108.0
1983	$27,500	57.1	$70,300	119.7	$75,300	109.7	$71,232	117.7
1984	$27,500	57.1	$72,800	127.5	$79,900	122.6	$74,094	126.4

		Price Adjusted VA Guaranty			RATIO: Price Adjusted Guaranty to Actual Guaranty		
	Maximum VA Guaranty	For Existing Homes	For New Homes	For All 1/ Homes	For Existing Homes	For New Homes	For All 1/ Homes
1974	$17,500	$17,500	$17,500	$17,500	1.00	1.00	1.00
1975	$17,500	$19,305	$19,157	$19,265	1.10	1.09	1.10
1976	$17,500	$20,836	$21,546	$20,942	1.19	1.23	1.20
1977	$17,500	$23,461	$23,788	$23,519	1.34	1.36	1.34
1978	$25,000	$26,633	$27,152	$26,679	1.07	1.09	1.07
1979	$25,000	$30,461	$30,662	$30,388	1.22	1.23	1.22
1980	$27,500	$34,016	$31,490	$33,461	1.24	1.15	1.22
1981	$27,500	$36,313	$33,586	$35,712	1.32	1.22	1.30
1982	$27,500	$37,078	$33,781	$36,394	1.35	1.23	1.32
1983	$27,500	$38,445	$36,706	$38,092	1.40	1.33	1.39
1984	$27,500	$39,813	$38,948	$39,622	1.45	1.42	1.44

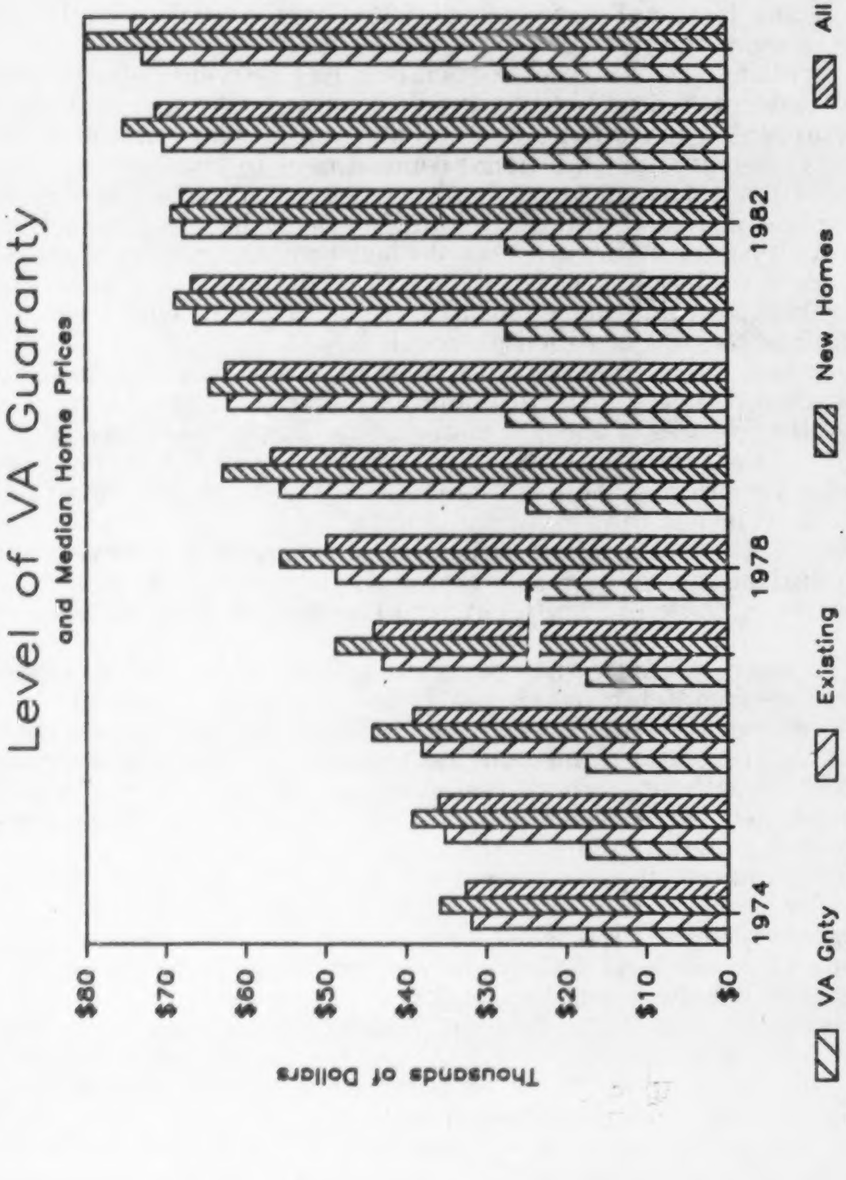
Sources: Bureau of the Census; National Association of Realtors.

1/Weighted average (by sales activity) of median sales prices of new and existing single-family homes sold.

Prepared by the Mortgage Bankers Association of America, Economics Department, March 1985.

Chart to Accompany Statement of Ronnie J. Wynn
Mortgage Bankers Association of America, May 1, 1985

EXHIBIT 12



Sources: Veterans Administration; Bureau of the Census; National Association of Realtors

Prepared by the Mortgage Bankers Association of America, Economics Department, April 1985

Mr. PRINCIPI. Mrs. Helfant.

Mrs. HELFANT. My name is Dorcas Helfant. I'm a realtor from Virginia Beach, VA, and I serve as the 1985 regional vice president for the States of Kentucky, North Carolina, South Carolina, Tennessee, and Virginia, and as chairman of the Realtor VA Task Force of the National Association of Realtors, a professional association of more than 670,000.

Mr. Principi, the National Association has actively opposed user fees on Federal related housing credit programs. We feel that these fees represent a tax on the homebuying public and contradict the Federal Government's traditional commitment to housing.

The National Association of Realtors is very concerned about any fee increase which would detrimentally affect the VA Home Loan Guaranty Program. However, we do feel that the administration's most recent proposal is a step in the right direction. We hope that this committee would not adopt a user-fee structure which exceeds the administration's modified proposal.

In addition, it is important to keep in mind that any user fee trigger must coincide with the commitment to increase the efficiency and effectiveness of the VA Home Loan Guaranty Program. The realtor VA task force has met with officials of the VA Home Loan Guaranty Program as well as members of your committee staff and collect the relevant information and data.

Based on its meetings, the task force developed the following recommendations which we want to provide the committee with as an alternative approach to improving the financial stability of the program.

No. 1, program audit. The realtor task force reiterated its strong support in the Veterans Home Loan Guaranty Program as a valued veteran benefit. However, given the current financial problems of the revolving fund and the number of years the program has existed without serious restructuring of its systems components, the task force recommended that Congress should be urged to request a program audit by the General Accounting Office.

No 2, in underwriting appraisal standards. We recognize that because of the very nature of the VA Home Loan Guaranty Program the underwriting standards are necessarily flexible. However, we continue to be concerned that every effort be made to ensure that the veteran borrower has the ability to assume and discharge the financial obligation of a home loan. To that end, we wholeheartedly support the recent efforts of the VA inspector general's office to thoroughly review the VA's existing underwriting criteria and identify possible areas of improvement.

With respect to the appraisal process, the realtor task force recommends the qualifications of VA appraisers to be made more uniform in the area of appraisal-related courses, training, and experience. More important, an adequate review process for quality control should be implemented.

On foreclosure proceedings, well, there's been a reduction in the availability of internal funding to the guaranty fund as a result of foreclosures. We are concerned that the VA foreclosure policies have perhaps exacerbated the decline in a revolving fund.

The association supported the so-called case-by-case analysis for VA defaulted properties which was mandated in the Deficit Reduction Act of 1984. We believe this approach is a viable alternative to the previous foreclosure policies. We urge its continued use in a comprehensive fashion.

In the area of foreclosure we understand the impact of the varying economic factors across the Nation. However, from evidence presented, part of the recent increase in foreclosures is due not only to these factors but due to the fact that many of the loans written in the eighties are not marketable due to high interest rates. And, if the veteran borrower who is sitting with this high-interest mortgage chooses to refinance his mortgage, he finds that an expensive process.

He is also penalized and has to pay the user fee twice. This makes it very difficult for him to bring his property to interest rate which is marketable, which is competitive or even is rentable if he must leave his area.

An area of major concern to us is the disposition of existing properties. Currently, the Veterans' Administration has some 22,000 properties in inventory valued at over $800 million. Because of the significance of these assets, the property management and disposition segment of the Loan Guaranty Program is in the best position to contribute to the financial health of the program by maximizing the resale of its accrued properties.

We are aware of the new approaches that the VA has been utilizing to improve the disposition process, including expediting processes, bonus incentives on older properties, and negotiated prices. We commend these efforts and encourage the VA to continue to seek similar marketing tools.

The realtor VA task force was particularly interested in this issue, and a considerable portion of our meeting with VA officials was devoted to it. Specifically, the task force discussed the need for development of a model program for the marketing and disposition of the VA's current inventory of properties.

Mr. Principi, thank you for the opportunity to appear today.

At this time I request that the full text of my testimony be submitted for the record and I would be happy to answer any questions you may have.

Mr. PRINCIPI. Thank you, Mrs. Helfant.

[The prepared statement of Mrs. Dorcas T. Helfant, 1985 regional vice president for region IV, chair of the realtor Veterans' Administration task force, National Association of Realtors, Virginia Beach, VA, follows:]

PREPARED STATEMENT OF DORCAS T. HELFANT, 1985 REGIONAL VICE PRESIDENT FOR REGION IV, CHAIR OF THE REALTOR VETERANS' ADMINISTRATION TASK FORCE, NATIONAL ASSOCIATION OF REALTORS, VIRGINIA BEACH, VA

My name is Dorcas T. Helfant. I am a REALTOR® from Virginia Beach, Virginia and the 1985 Regional Vice President for the states of Kentucky, North Carolina, South Carolina, Tennessee and Virginia. I am also the Chair of the newly created REALTOR® VA Task Force appointed by the NATIONAL ASSOCIATION OF REALTORS® President, David D. Roberts.

On behalf of the more than 670,000 members of the NATIONAL ASSOCIATION OF REALTORS®, I want to thank the Chair, Senator Murkowski, and members of the Committee for the opportunity to present our recommendations on possible administrative changes in the VA Home Loan Guaranty Program as alternatives to increasing the one percent "user fee".

OBJECTIVE OF THE VA HOME LOAN GUARANTY PROGRAM

With the conclusion of World War II, Congress created the Veterans Administration Home Loan Guaranty Program in 1944 to assist returning veterans with obtaining homeownership. The program was in response to the economic and sociological problems associated with postwar readjustments, and it was intended to benefit men and women because of their service to this country. There was no intention that the program serve as an instrument to achieve any federal economic objective. Instead, since its inception, the sole objective of the program has been to assist eligible veterans to become homeowners. Today, it is estimated that the program has served almost 12 million veterans in buying their homes.

The drafters of the original legislation realized that "credit" was the essential ingredient to this program. Therefore, the program was structured to provide veterans with the most favorable credit in an attempt to compensate for any lost opportunities they may have suffered in the credit market during the period of their military duty.

To be eligible for the home loan guaranty benefit, the only criteria is that the individual be an "eligible veteran" (meets service and discharge requirements), the loan be for eligible purposes, the home be occupied by the veteran, and that the veteran meet income and credit standards. Therefore, not only does the program seek to provide favorable credit, but its primary qualification for participation is that the individual be an "eligible" veteran.

In carrying out the objective of credit accessibility for ALL veterans, the program has become, for some, a benefit to which they feel entitled and to others a bastion of last resort. To both groups, however, the program has enabled them to purchase a home below conventional rates and usually with no down payment.

PROPOSED FEE INCREASE

In the Fiscal Year 1986 Budget Proposal, the Administration has recommended, as a part of the budget deficit reduction package, an increased "user fee" from the present 1 percent to 5 percent. The origin of this increase is OMB Circular A-70 which purportedly directs federal credit programs towards greater self-sufficiency through cost-effectiveness.

In responding to the issue of the budget deficit, the NATIONAL ASSOCIATION OF REALTORS® has previously testified before the House and Senate Budget Committees, the House and Senate Banking Committees, and the House Veterans Affairs Subcommittee on Housing & Memorial Affairs. We have recommended that any changes in taxes or tax-like user charges be designed to encourage investment in housing, homeownership, commerce and industry.

Mr. Chairman, the NATIONAL ASSOCIATION OF REALTORS® has actively opposed "user fees" on federally-related housing credit programs. We feel that these fees represent a tax on the homebuying public and contradict the Federal government's traditional commitment to housing.

Originally, the Administration in its February 4, Fiscal Year 1986 Budget Proposal, recommended an increase in the VA "user fee" from the current 1 percent to 5 percent. This dramatic increase will discourage veterans from participating in the program. As we testified in March, this 400 percent increase will likely cause a reduction of 17 to 22 percent of the number of VA originations. This number certainly represents a very conservative estimate and does not include those veterans who, even though they can afford the increased fee, will shy away from the program because of the disincentive created by a 1-5 percent increase.

The Senate Budget Committee's recent vote to increase the VA "user fee" to 3.8 percent -- a 280 percent increase over current levels -- is only slightly less damaging to the VA program and the national economy than the Administration's February 4th proposal.

The NATIONAL ASSOCIATION OF REALTORS® is sensitive to the deficit problems of the VA Revolving Fund. Optimally, we would hope that the administrative changes recommended here today will provide the VA Home Loan Guaranty Fund with the type of monetary relief it would need to continue its objectives.

We have been in communication with the Administration and understand that they have taken a modified position on the proposed VA "user fee" increase. The fee would be increased from the current 1 percent to 3.8 percent over the next five years. Specifically, the fee would be increased from 1 to 2 percent for fiscal year 1986, from 2 to 2.5 percent for fiscal year 1987, from 2.5 to 3 percent for fiscal year 1988, from 3 to 3.5 percent for fiscal year 1989 and from 3.5 to 3.8 percent for fiscal year 1990.

Most importantly, there would be a triggering mechanism that would be activated either up or down depending on the actuarial soundness of the Revolving Fund. The determination would be made on an annual basis by the VA Administrator after he or she has had an opportunity to review the financial accounts of the VA Home Loan Guaranty Program. If the VA Administrator decides that the Fund requires additional money to remain solvent through the coming fiscal year, then he or she could authorize an increase in the fee for that proceeding year. Conversely, if the VA Administrator discovers that the Fund is more than adequately financed, then he or she would authorize a reduction in the fee for the proceeding year.

The NATIONAL ASSOCIATION OF REALTORS® is very concerned about any fee increase which would detrimentally effect the VA Home Loan Guaranty Program. However, we do feel that the Administration's most recent proposal is a step in the right direction, and we hope that this Committee would not adopt a "user fee" structure which exceeds the Administration's modified proposal. In addition, it is important to keep in mind that any "user fee" trigger must coincide with a commitment to increase the efficiency and effectiveness of the VA Home Loan Guaranty Program.

ALTERNATIVES TO INCREASING VA FEES

Mr. Chairman, because of our continuing interest in the viability of the Veterans Administration Home Loan Guaranty Program, a special Task Force was recently appointed by the NATIONAL ASSOCIATION OF REALTORS® President, David D. Roberts, to gather information, study the VA Program and recommend possible improvements. The REALTOR® VA Task Force met with officials of the VA Home Loan Guaranty Program, as well as, members of your Committee staff, and collected the relevant information and data. Based on its meetings, the Task

Force developed the following recommendations which we want to provide the Committee with as alternative approaches to improving the financial stability of the VA Home Loan Guaranty Program.

It is important to note, however, that the recent solvency problems facing the program are not simply a consequence of its administrative operations. While the continuing economic recovery has contributed to the health of the housing industry, as a whole, there are still various socio-economic factors which remain as incidental to mortgage default. These factors are similarly present in the VA housing program. The default rate for the VA Home Loan Guaranty Program is not excessive and, in fact, parallel the industry norm.

The REALTOR® VA Task Force reiterated its strong support of the Veterans Home Loan Guaranty Program as a valued veteran benefit. However, given the current financial problems of the Revolving Fund and the number of years the program has existed without serious restructuring of its system's components, the Task Force recommended that Congress should be urged to request a program audit by the General Accounting Office (GAO).

- Underwriting and Appraisal Standards: We recognize that, because of the very nature of the VA Home Loan Guaranty Program, the underwriting standards are necessarily "flexible". However, we continue to be concerned that every effort be made to ensure that the Veteran borrower has the ability to assume and discharge the financial obligation of a home loan.

It is our understanding that the Inspector General's Office of the Veterans Administration has recently initiated a long-term study to thoroughly review the Administration's existing underwriting criteria to identify possible areas of improvement. We wholeheartedly support this effort, and urge the VA to strengthen and standardize its criteria, where necessary, in order to minimize the risk to the Revloving Fund.

We are aware that the Inspector General's study of the appraisal practices in the Home Loan Guaranty Program has been completed. Although it remains an internal document, we understand that several recommendations strengthening the appraisal system have been provided. With respect to the appraisal process, the REALTOR® VA Task Force recommended that the qualifications of VA appraisers should be made more uniform in the area of appraisal-related courses, training and experience. More importantly, an adequate review process for quality control should be implemented.

- Foreclosure Procedures: As I am sure this Committee knows, the VA Loan Guaranty Revolving Fund was, until recently, self-sustaining. In fact, only 4 percent of the total VA loans which have been originated since the inception of the guaranty program have resulted in foreclosure.

While a reduction in the availability of internal funding to the Guaranty Fund has been one of the major contributors to its financial ills, we are concerned that the VA's foreclosure policies have, perhaps, exacerbated the decline in the Revolving Fund. Prior to the enactment of the Deficit Reduction Act of 1984 (July 1984), the Veterans Administration, in about 95 percent of its default cases, chose to acquire and resell the foreclosed property, while compensating the lender for its direct costs incurred by the default and foreclosure.

In an effort to address this issue, Congress adopted a provision in the Deficit Reduction Act, which requires the VA to undertake a "case-by-case" analysis in all default situations to determine which foreclosure method is most cost effective. These two methods include either: (1) acquisition and resale of the defaulted property, with compensation to the lender for its costs; or (2) payment of the loan guaranty only. According to the VA, this new procedure has, in fact, reduced its acquisition rate from 95 percent to 90 percent.

We supported this approach when it was debated last year, and believe that it is a viable alternative to the previous foreclosure policies, and we urge its continued use in a comprehensive fashion. We also recommend that Congerss periodically monitor and evaluate the effects of the "case-by-case" method.

- Mortgage Guaranty Limit: Presently, there is legislation to increase the VA mortgage guaranty limit before both the House and Senate Veterans Affairs Committees. The VA mortgage guaranty limit of $27,500 has not been changed since 1980. However, since this time, the U.S. Department of Commerce has reported a price increase for new home median sales by over 24 percent. This significant increase in housing costs is responsible for the need to increase the loan guaranty limit.

Currently, there is a growing number of areas nationwide where the Veterans Home Loan Guaranty Program is being outpriced by housing costs. A glaring example of this program is in California where the largest population of veterans, over 3 million, reside and where the housing costs are 50 - 60 percent above the national average.

The NATIONAL ASSOCIATION OF REALTORS® supports the increase in the guaranty limit and consider it a viable alternative to increasing the current 1 percent "user fee". By increasing the VA mortgage guaranty limit, the program will support a higher principal loan amount which will translate into an increased dollar amount of the 1 percent "user fee" into the VA Revolving Fund. Although the increase in the VA mortgage guaranty limit may also increase the VA Revolving Fund's foreclosure risk, a combination of stricter appraisal and underwriting standards should more than minimize the possible additional risk.

- Disposition of Properties: Currently, the Veterans Administration has some 22,000 properties in inventory valued at over $800 million. Because of the significance of these assets, the property management and disposition segment of the loan guaranty program is in the best position to contribute to the financial health of the program by maximizing the resale of its accrued properties.

We are aware of the new approaches that the VA has been utilizing to improve its disposition process, including expedited processing, bonus incentives on older properties, and negotiated pricing. We commend these efforts, and encourage the VA to continue to seek similar marketing tools.

As part of our continuing efforts to maintain an open dialogue with both the VA and FHA, the NATIONAL ASSOCIATION OF REALTORS® meets periodically with officials of the VA, as part of our FHA/VA Monitoring Network. Our members have discussed the property disposition situation and, in concert with the VA, we are exploring ways in which REALTORS® can assist in the resale of these properties.

The REALTOR® VA Task Force was particularly interested in this issue, and a considerable portion of its meeting with VA officials was devoted to it. Specifically, the Task Force discussed the development of a model program for the marketing and disposition of VA's current inventory of properties.

Mr. Chairman, in conclusion, we strongly recommend that this Committee further review and evaluate the specific components of the VA Home Loan Guaranty Program. The "user fee" is not the only solution of the Program's deficit - more specific program related changes must be considered for the long-term health and maintenance of the VA Program.

I want to express my appreciation to the Committee for the opportunity to appear today. At this time, I request that the full text of my testimony be submitted for the record and, I would be happy to answer any questions you may have. Thank you.

The NATIONAL ASSOCIATION OF REALTORS® is comprised of more than 1,806 local boards of REALTORS® located in every state of the Union, the District of Columbia, and Puerto Rico. Combined membership of these boards is over 675,000 persons actively engaged in sales, brokerage, management, counselling, and appraisal of residential, commercial, industrial, recreational and farm real estate. The activities of the Association's membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and residential real estate development, including development, construction and sales of condominiums. The Association has the largest membership of any association in the United States concerned with all facets of the real estate industry.

Elected officers are: President David D. Roberts, Mobile, Alabama;
President-elect Clark E. Wallace, Moraga, California;
First Vice President William M. Moore, Denver, Colorado;
Treasurer Phillip C. Stark, Madison, Wisconsin.

The Executive Officer is Jack Carlson.

The Senior Vice President, Government Affairs is Albert E. Abrahams and the Vice President and Legislative Counsel, Government Affairs is Gil Thurm.

Headquarters of the Association are at 430 North Michigan Avenue, Chicago, Illinois 60611. The Washington Office is located at 777 14th Avenue, N.W., Washington, D.C. 20005. Telephone: (202) 383-1000.

REALTOR®

Mr. PRINCIPI. Mr. Smith.

Mr. SMITH. My name is David Smith and I am a homebuilder from McDowell, VA.

The National Association of Home Builders is a trade association of the Nation's home building industry, of which I am first vice president.

Almost 20 percent of our builder members are involved in building housing financed under the Veterans' Administration housing programs. I am pleased to present our views on the oversight of the VA Home Loan Guaranty Program and the administration's fiscal year 1986 budget proposals, including the increase in VA fees and the elimination of the administratively set VA interest rate.

First, I would like to take this opportunity to comment on the Veterans' Administration Home Loan Guaranty Program in general.

The VA housing programs have given four decades of veterans and their families the opportunity not only to obtain home ownership but to put down roots and establish community ties. Throughout its history the Veterans' Administration has operated a very successful Guaranteed Home Loan Program that continues to achieve the social policy goals spelled out by our Congress.

The VA has done an excellent job in carrying out the housing entitlement programs afforded veterans. The National Association of Home Builders has always supported the VA Home Loan Guaranty Program and believes the VA to be one of the best Federal agencies in terms of service to the consumer and to the Nation's home builders.

The administration and Budget Committee action to increase the fee is contrary to long-standing Federal policy. Congress spoke very clearly in 1944 when authorizing the GI Home Loan Program as an entitlement program to enable veterans to obtain mortgage credit.

Over time, Congress has acted wisely to increase the entitlement, expand the category of eligible veterans and extend the period during which entitlements could be utilized.

There has been a bipartisan commitment over the past 40 years to help veterans purchase their own homes. It should take no less than explicit congressional action to retreat from this policy.

The proper course of action is to cover the current shortfalls in the VA fund, if they are necessary, by appropriation.

The National Association of Home Builders would be happy to work with Congress in developing alternatives that will minimize current losses while preserving the program over the longer term. This would include minimizing current losses through effective property disposition and management and sound underwriting procedures. A white paper done in response to questions by the committee is attached. This paper may also be helpful for this purpose.

Mr. Chairman, we support the continued use of administratively set VA interest rate. At our January convention the NAHB passed a resolution—attachment A—which supports the dual system of a floating FHA rate and an administratively established VA rate to be continued for at least 2 more years. This will allow the operation of the FHA floating rate to be tested over time, including times of high interest rate volatility.

I would also like to comment in support of Senator Cranston's bill, S. 9. This bill raises the loan guaranty maximum from $27,500 to $35,000 and provides for an adjustable rate mortgage for the VA similar to that provided under the demonstration program for FHA in the 1983 Housing Act.

Attachments B and C to my testimony show the need to increase the loan guaranty maximum. Given a 32-percent increase in the cost of housing since the last time the loan guaranty maximum was raised in 1980, we believe that an increase in the loan guaranty amount is well justified.

Adjustable rate mortgages have proven to be valuable tools in the marketplace. We would basically support the concept of an adjustable rate mortgage for the VA as an additional mortgage instrument for the veteran home buyer. We feel, however, that the 1-percent interest rate increase limitation per year in the Senate bill should be made more flexible.

In closing I would like to emphasize our unequivocal opposition to the increase in the VA user fees for veteran home buyers. It is essential that the VA remain true to its basic responsibility of providing credit assistance to veterans. I would be happy to respond to any questions you may have. Thank you for the opportunity to appear before you this morning.

Mr. PRINCIPI. Thank you very much, Mr. Smith.

[The prepared statement of David E. Smith, first vice president, National Association of Home Builders, Washington, DC, follows:]

PREPARED STATEMENT OF DAVID E. SMITH, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, WASHINGTON, DC

Mr. Chairman and Members of the Committee:

My name is David Smith and I am a home builder from McDowell, Virginia. I build residential and commercial properties in both Maryland and Virginia. I am appearing today on behalf of the more than 131,000 members of the National Association of Home Builders (NAHB), who employ over 3 million workers. NAHB is a trade association of the nation's homebuilding industry, of which I am First Vice President. Almost 20 percent of our builder members are involved in building housing financed under the Veterans Administration (VA) housing programs.

It is a pleasure to appear before you, Mr. Chairman, and to congratulate you in your new role as Chairman of this Committee. We are looking forward to working with you and would like to assist you in any way we can to strengthen and improve the VA housing programs.

I am pleased to present our views on the oversight of the VA Home Loan Guaranty Program, and the Administration's FY 86 budget proposals including the increase in the VA fee, the elimination of the administratively-set VA interest rate, and the consolidation of VA offices. In addition, I would like to comment in support of the two legislative initiatives in Senator Cranston's (D-CA) bill, S.9, which increases the VA home loan guaranty maximum from $27,500 to $35,000 and provides for adjustable rate mortgages (ARM's) for the veteran homebuyer.

VA HOME LOAN GUARANTY PROGRAM

First, I would like to take this opportunity to comment on the Veterans Administration Home Loan Guaranty Program in general. VA housing programs have given four generations of veterans and their families the opportunity not only to obtain homeownership but to put down roots and establish community ties. Since the inception of the program, the VA has guaranteed over 11.5 million loans with a value of around $250 billion. Since 1970, the VA Home Loan Guaranty program has financed 6 percent of total housing starts.

Throughout its history, the Veterans Administration has operated a very successful guaranteed home loan program that continues to achieve the social policy goals spelled out by Congress. Since the loan guaranty revolving fund was created in 1962, the program operated without any additional cost to the taxpayer for over 20 years through fiscal year 1983. In FY'84, for the first time, Congress appropriated money for the depleted Loan Guaranty Revolving Fund. Thus, aside from the last two years, the VA guaranteed home loan program has been self-sufficient.

The VA has done an excellent job in carrying out the housing entitlement programs afforded veterans. NAHB has always supported the VA Home Loan Guaranty Program and believes the VA to be one of the best federal agencies in terms of service to the consumer and to the home builder.

ADMINISTRATION'S FY 86 BUDGET PROPOSALS

VA User Fee Increase

Mr. Chairman, the President's budget calls for an increase in the VA user fee from one percent to five percent and Senate Budget Committee action increases the fee to 3.8 percent.

NAHB views this fee, as well as the user fee increases proposed for the Federal Housing Administration (FHA) and the Government National Mortgage Association (GNMA) and the new fees imposed on activities of the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), as part of a continuing effort by the Administration to restrict essential federal credit programs. We oppose all of these fees because of the increased cost to the homebuyer and the likelihood that they may cause losses in the Loan Guaranty Revolving Fund rather than increase revenues.

Congress spoke very clearly in 1944 when authorizing the GI Home Loan Program as an entitlement program to enable veterans to obtain mortgage credit. Over time, Congress has acted wisely to increase the entitlement, expand the category of eligible veterans, and extend the period during which the entitlement could be utilized. There has been a bipartisan commitment over the past 40 years to help veterans purchase their own homes; it should take no less than explicit congressional action to retreat from this policy.

The Proposed Fee Is Unrelated to Cost of Program

The user fee was proposed by the Office of Management and Budget (OMB) to avoid a projected $404.6 million shortfall in the loan guaranty fund in FY'86. A five percent fee, however, will bring in $604.6 million, $200 million more than projected by the Administration needed to sustain the program. In addition, an analysis by the Congressional Budget Office (CBO) states there is no need for any appropriation at all to supplement the Loan Guaranty Revolving Fund (LGRF). The CBO analysis states that the loan guaranty revolving fund "could sell sufficient assets to finance the fund's projected deficits through 1990, thereby eliminating the need for appropriations during this period."

Thus, the fee is really like a tax. It is not needed for the viability of the program and is therefore putting a selective tax burden on future veteran homebuyers.

Impact of the Fee on Veteran Mortgage Payments

The impact on the monthly mortgage payment of the fee increase is substantial. It has been estimated by the VA that an increase in the fee to five percent will add almost $30 to a veteran's monthly mortgage payment. If the fee were raised to 3.8 percent, assuming a $60,000 mortgage at 12-1/2 percent on a 30-year fixed rate loan, the monthly mortgage payment increase is almost $20 per month. Proposed GNMA fees would add an additional $2 per month.

The Increased Fee Will Cause Losses to the Fund

The increased fee will cause sizeable losses in the Loan Guaranty Revolving Fund. Loan originations will decrease offsetting projected revenue and negative amortization will cause higher default rates.

Negative Amortization: The severe economic recession of the early eighties, combined with the end of the rapid appreciation in home prices that had been associated with inflation, has resulted in unusually high foreclosure and loss rates throughout the mortgage sector. Analysis of the cause of these foreclosures and the types of loans most likely to default shows clearly that low downpayments and negative amortization are the most dangerous aspects in a disinflationary environment. The borrower naturally defaults when he has no equity in the property.

Under the Administration proposal, the zero downpayment VA loan would begin negatively at 105 percent of value. Even assuming that the property appreciates at five to seven percent a year, it will be several years before equity is sufficient for the veteran to break even on a sale. Most defaults ordinarily occur in the first few years of the loan, and during this period the VA will not be well-secured. The user fee proposal could destroy the balance in the program and exacerbate the problem, not cure it.

Decline in Use of Program: The proposed fee is not likely to produce the projected revenue. Loan originations will decrease as veterans decline to use the program because of the fee. Spokesmen for the VA have predicted that the decline in VA activity could be as great as 50 percent and the CBO analysis stated that new loan originations would be decreased by 20 percent.

If FY'86 mortgage volume were $13.5 billion with a one percent fee, $135 million in revenue would be produced. If the fee were raised to five percent and volume fell to $6.75 billion, revenue produced would amount to $337 million. While revenue would increase by $200 million, over 100,000 veterans would have been denied access to a longstanding benefit.

It is, of course, difficult to quantify the decline in VA volume precisely. It can be said with certainty, however, that a decline below $10.5 billion, as compared with $12.5 billion in 1984, would result in less additional revenue than the $404.6 million OMB projects to shore up the revolving fund. The decline in VA activity is likely to be much greater than this both because the larger fee would put homeownership under the VA Program beyond the reach of many eligible borrowers and because the larger fee would make the VA program more expensive than other alternatives.

What Are the Alternatives?

As the foregoing illustrates, the losses currently being experienced by the Veterans Administration cannot be cured by charging them to new borrowers. This merely postpones the problem to the future and, because of the lasting damage to the program, does so less efficiently than if Congress were simply to appropriate funds to cover the shortfall. Even with the five percent fee, reduced volume would create the possible need for an appropriation of approximately $200 million.

The proper course of action is to cover the current shortfall in the VA fund by appropriation if it is necessary. In addition, action should be taken to preserve the long-term viability of the program. Our preliminary analysis has provided some areas for consideration.

(1) Current losses should be minimized through effective property disposition and management.

(2) The Veterans Administration holds property with substantial liquidation value, but cannot dispose of it rapidly enough to cover current losses. Congress should explore whether there is some way that VA can borrow against the liquidation value of its inventory to cover at least a portion of current losses, thereby minimizing the size if an appropriation is needed for FY'86.

(3) New business must be written on as sound a basis as possible, given both the entitlement nature of the program and today's disinflationary environment. The analysis of what is required should take into account the relatively good record of the veteran borrower over the long-term, including the period from the mid-sixties to mid-seventies when price appreciation was less of a factor.

NAHB would be happy to work with the Congress and other interested groups in developing alternatives that will minimize current losses while preserving the program over the longer term.

Negotiated Rate

Mr. Chairman, also contained in the Administration's FY'86 VA budget package is a proposal to eliminate the administratively-set VA interest rate and to allow for a negotiated rate between the buyer and the seller. As you are aware, the administratively-set rate was abolished in the 1983 Housing Act for loans insured by the Federal Housing Administration (FHA).

At our January convention, NAHB passed a resolution (Attachment A) which supports the dual system of a floating FHA rate and an administratively-established VA rate to be continued for at least two more years. This will allow for the operation of the FHA floating rate to be tested over time, including times of high interest rate volatility.

If the VA's authority to set a maximum interest rate ceiling were eliminated, there would be no way to reestablish a benchmark rate if less stable interest rates returned and such a benchmark rate again became necessary.

I would also like to take this opportunity to commend the VA Administrator for his successful administration of the VA rate last year. His sensitivity to market conditions made the VA prevailing rate a true "national mortgage rate benchmark." The current system is working well, and we urge that it be continued.

Consolidation of VA Offices

Also included in the FY'86 budget is a proposal by the Administration to consolidate the VA's 59 regional offices into three offices, similar to action proposed by the Administration in 1981. Mr. Chairman, we opposed that action then and we oppose it now. While we have been told that this proposal would not disrupt loan processing activities for veterans and builders, as there would still be contact points at the various regions, I have serious questions as to the efficiency of this system and what might amount to diminished services.

Legislation passed in 1981, which NAHB supported, stated that the Administration must submit a detailed plan and justification before any administrative reorganization is implemented. This detailed justification of reorganization is to be submitted on the same day the President submits his budget to Congress, and the proposal is not to be effective until the beginning of the fiscal year nine months later -- giving Congress time to debate the issue. It is our understanding that a "detailed" justification has not been sent. This, in itself, should technically delay any consideration of reorganization until FY '87.

LEGISLATIVE PROPOSALS

I would also like to comment in support of S.9, legislation affecting the VA Home Loan Guaranty Program which has already been introduced in the Senate. This bill raises the loan guaranty maximum from $27,500 to $35,000 and provides for an adjustable rate mortgage (ARM) for the VA, similar to that provided under a demonstration program for FHA in the 1983 Housing Act.

Loan Guaranty Maximum

Attachments B and C to my testimony show the need to increase the loan guaranty maximum. Since 1974, the sales price of new single family homes has increased at a much greater rate than the maximum loan guaranty. The median sales price of a new home went from $35,900 in 1974 to $79,900 in 1984, a 123 percent increase. The loan guaranty maximum increased only 57 percent in the same amount of time -- from $17,500 to $27,500. Comparing the NAHB 1985 new home sales estimate of $85,100 to the 1980 figure of $64,600, the last time the loan guaranty was raised, new home prices will have increased over 32 percent (Attachment B).

The VA Loan Guaranty program, of course, is not isolated from price increases. The average sales price for new homes built with a VA loan guaranty increased from $30,305 in 1974 to $77,003 in

1984, an increase of over 154 percent -- greater than the percent increase for new home sales in general. Average loan amounts for new housing have climbed by 146 percent during this same period (Attachment C).

Given the substantial increases in the cost of housing since the last time the loan guaranty maximum was raised, we believe that an increase in the loan guaranty amount is well justified.

You may want to consider the establishment of a mechanism that would automatically trigger an increase in the loan guaranty maximum as home prices rise. We would also like to see a formula established to provide differentials for high cost housing areas, similar to FHA.

Adjustable Rate Mortgages

Adjustable Rate Mortgages (ARMs) have proven to be a valuable tool in the market place. We would basically support the concept of an adjustable rate mortgage for the VA as an additional mortgage instrument for the veteran homebuyer.

We feel, however, that the one percent interest rate increase limitation per year in the Senate bill should be made more flexible. FHA's limited experience to date seems to indicate that there is little investor interest in loans with this provision. Most conventional mortgages have a two percent interest rate cap. This legislation should be re-drafted to allow the Administrator to respond flexibly to evolving market conditions.

NAHB WHITE PAPER

We have attached a White Paper (Attachment D) on the Veterans Administration's Home Loan Guaranty program which addresses questions from the Committee on:

(1) How the homebuilder fits into the program.

(2) Why default rates are high and why there are shortages in the Loan Guaranty Revolving Fund.

(3) Are appraisals overstating value.

(4) Assessment of VA construction standards; and

(5) Specially adapted housing.

I hope that our comments will be of assistance as you are evaluating what we believe to be one of the best run government housing programs.

CONCLUSION

In closing, I would like to emphasize our opposition to the increase in the VA user fee for veteran homebuyers. It is essential that the VA remain true to its basic responsibility of providing credit assistance to veterans for the purchase of housing and to make maximum use of the loan guaranty program. The loan guaranty entitlement should not be denied our veterans and service personnel who have so ably served our country.

Attachment A

NAHB Resolution

Title:	VA Prevailing Rate
Original Sponsor:	HBA of Greater Chicago

WHEREAS, 1984 witnessed both the introduction of Federal Housing Administration floating rates and relatively stable interest rates; and

WHEREAS, legislation has been introduced that would eliminate the FHA floating rate; and

WHEREAS, the Office of Management and Budget (OMB) has instructed the Veterans Administration to eliminate the VA administered rate; and

WHEREAS, during 1984, the Veterans Administration's prevailing rate served as a national "mortgage rate benchmark" allowing builders to enjoy the best of both worlds: an FHA floating rate plus an easy and creditable way to quote rates to buyers; and

WHEREAS, if the VA administered rate were eliminated, there would be no way to reestablish a "national mortgage benchmark" if less stable rates returned and such a benchmark rate again proves necessary,

NOW, THEREFORE, BE IT RESOLVED:

- That Congress and the Department of Housing and Urban Development and other involved administrative officials be urged to allow the dual system of floating Federal Housing Administration rates and administratively established Veterans Administration rates to be continued for at least two more years so that full success of an FHA floating rate can be verified over time and during times of high interest rate volatility as well as the lower volatility which characterized 1984; and
- That the Administrator of VA be commended for the flexible, objective and market-oriented administration of the VA rate during the past year and encouraged to similarly respond sensitively to market conditions in the future.

Approved by the Board of Directors - January, 1985

ATTACHMENT B

MEDIAN SALES PRICE OF NEW HOMES SOLD/ LOAN GUARANTY MAXIMUM COMPARED TO 1974

	Median Sales Price/New Homes	% Increase Over 1974	Loan Guaranty Maximum	% Increase Over 1974
1974	$35,900	N/A	$17,500	N/A
1975	$39,300	9.5	$17,500	0
1976	$44,200	23.1	$17,500	0
1977	$48,800	35.9	$17,500	0
1978	$55,700	55.2	$25,000	42.9
1979	$62,900	75.2	$25,000	42.9
1980	$64,600	79.9	$27,500	57.1
1981	$68,900	91.9	$27,500	57.1
1982	$69,300	93.0	$27,500	57.1
1983	$75,300	109.7	$27,500	57.1
1984	$79,900	122.6	$27,500	57.1
est. 1985	$85,100	137.0	$35,000	100.0

Source: U.S. Department of Commerce, Bureau of the Census, Series C-25; Compiled by NAHB.

ATTACHMENT C

SALES PRICES AND LOAN AMOUNTS
VA PROGRAMS 1974 - 1984

	1974	1984	% INCREASE
VA PROGRAMS			
Average Sales Price (new housing)	$ 30,305	$ 77,003	154.1 %
Average Loan Amount (all housing)	26,531	63,998	141.2
Average Loan Amount (new housing)	29,415	72,427	146.2
Average Loan Amount (existing housing)	25,675	59,837	133.1

Source: Veterans Administration, compiled by NAHB

(ATTACHMENT D)

VETERANS ADMINISTRATION HOME LOAN GUARANTY PROGRAM

Housing Policy and Mortgage Finance
National Association of Home Builders

Veterans Administration Home Loan Guaranty Program

1. How the Home Builder Fits into the Program.

The VA Home Loan Guaranty Program (HLGP) has been a very important housing finance vehicle since enacted in 1944. Builder participation in the program has grown throughout the years. In the 1960's the number of loans guaranteed per year averaged about 175,000 and increased to 320,000 per year in the 1970's. After a dip in activity during the recession of the early 1980's, VA housing is returning to high levels of use.

The VA HLGP has financed 6 percent of total housing starts since 1970. For the years 1975 through 1983, the VA HLGP represents 6.67 percent of all housing starts.

The home builder is the entrepreneur who coordinates the delivery of a new home to a buyer. The builder frequently develops the land, obtains local governmental approval, constructs the house, coordinates inspections and appraisals, markets the product, and arranges for financing. Therefore, it is the builder who usually explains the range of financing alternatives to potential buyers. Clearly, builders view the VA HLGP as a most useful financing alternative and recommend it to veteran buyers.

Most VA loans are packaged, along with FHA mortgages, as GNMA-guaranteed securities and then sold on Wall Street to a variety of investors. Through the GNMA program, Veterans can obtain 30-year, fixed-rate mortgages at competitive interest rates.

2. Problem Areas in VA HLGP

a) Why default rates are high?

The severe economic recession of the early 1980's, combined with the end of the rapid appreciation in home prices associated with inflation, has resulted in unusually high foreclosure and loss rates throughout the mortgage sector. Defaults in the areas bordering the Great Lakes have now peaked and losses should be reduced as the economic recovery progresses. Unfortunately, there is new distress in energy-dependent cities such as Houston and Denver, as well as in Iowa and other agricultural regions. Analysis of the causes of these foreclosures and the types of loans most likely to default, shows clearly that low downpayments combined with negative amortization are the most dangerous features in a disinflationary environment.

The recent VA experience is comparable to that of FHA and private mortgage insurers, and is actually better than might be expected given the high percentage of low-downpayment loans in the VA total. In the fourth quarter of 1984, delinquency rates (30 days and over) were: conventional, 4.11 percent; VA, 6.62 percent; and FHA, 7.41 percent. In FY 1984 only 36.5 percent of VA borrowers made downpayments (constituting 40 percent of the dollar volume guaranteed). When a borrower chooses to finance the 1 percent VA fee (proposed to go to 5 percent by the Administration and 3.8 percent by the Senate Budget Committee), the borrower clearly has no equity in the zero downpayment loan. Even assuming that the property appreciates at 5 to 7 percent a year, it will be several years before the equity is sufficient for the veteran to break even on a sale. Most defaults occur in the first few years of the loan, a period during which the VA has not been well secured.

Another factor behind the VA default rate is the limited size of the loan guaranty maximum. Using the 1985 estimated cost of housing, home prices have increased 137 percent since 1974. The loan guaranty maximum has increased by only 57 percent since 1974—to $27,500.

In summary, national and regional economic recessions have combined with the process of disinflation to create a high level of defaults on low-downpayment VA loans. Some 104,794 defaults were pending as of December 31, 1984, representing a 5.7 percent increase over the 99,061 defaults pending at the end of 1983. In FY'83, 20,189 claims were paid and this number increased 16 percent to 23,355 in FY '84. In 1985, the low downpayment VA loans will again be a potential source of new defaults and foreclosures subject to the breadth of the economic recovery.

b) Why are there shortages in the VA Loan Guaranty Revolving Fund (LGRF)?

The LGRF will require an infusion of $404.6 million in FY '86 to meet program needs. Only in recent years has the LGRF been substantially depleted, requiring appropriations of $100 million and $306.6 million over the past two years. Clearly, the economic conditions combined with low downpayment loans—as discussed earlier—have had this negative effect on the LGRF.

Prior to FY '83, the VA did not charge any guaranty fee. A half-point guaranty fee was instituted in FY '84, but the revenue went to the Treasury, not to VA. In FY '85 the fee was increased to one percent and the funds are to be retained by VA. Since the new fee system has been in effect for only six months, it has not been able to accumulate funds sufficient to offset losses.

To reduce losses, the VA has improved its management of property sales from inventory. From a peak of 22,316 properties in inventory during March, 1984, the VA has reduced that number to 21,585. Property sales in FY '84 were 18 percent higher than in FY '83 and FY '85 sales are running 30 percent higher than in FY '84.

In recent testimony before the House Subcommittee on Housing and Memorial Affairs, the VA listed several steps it has taken to reduce deficits in the the LGRF:

1) creation of a special task force for the 7 worst inventory regions.
2) reasonable offers are being accepted on inventory that is unsold after 6 months on the market.
3) sales commission bonuses are being offered on older, lower-priced, hard-to-sell properties
4) discounts of 10% are given to cash purchasers
5) test auctions are being held for hard-to-sell properties

3. Are appraisals overstating value?

The VA uses fee appraisers to assign the reasonable value which is the maximum loan amount the VA will guarantee. VA (like FHA) designates panels of certified appraisers for different parts of the country. As mortgagees process VA loan applications, an appraiser is assigned randomly from the panels.

An increasing number of VA loans are being processed under the "automatic processing" system -- a system designed to speed processing by delegating most of the loan underwriting process to the private lender. However, fee appraisers are requested and assigned under this system just as under normal processing, and the VA field offices give final approval on all loans.

The VA appraisal process apparently has been satisfactory. The GNMA security program requires FHA and VA loan originators who sell their loan production by issuing GNMAs to advance their own funds to cover late payments on delinquent loans. This discipline has been effective in encouraging sound loan underwriting and realistic property appraisals.

4. Assessment of VA Construction Standards

NAHB has never objected to the quality of VA construction standards. The VA has and still does rely on the MPS (minimum property standards). Building inspections are made by VA inspectors.

However, NAHB has long opposed the duplicative federal and local inspection process which requires the VA builder not only to meet the MPS and local code standards, but also to go through two sets of inspections. HUD now defers to acceptable local codes based on national model codes. If the local code is satisfactory, FHA will accept the approval of the local inspection process, thereby saving the builder a good deal of time and money.

5. Specially Adapted Housing

Through 1984, a total of 563 blind veterans and veterans who have lost the use of their hands have received grants averaging $4585 (Special Housing Adaptations Grant). Likewise through 1984, 19,135 severely disabled veterans were approved for $306 million of grants for specially adapted housing. These programs will continue and, effective January 1, 1985, the maximum Special Housing Adaptations Grant was increased to $6000 from $5000 while the Specially Adapted Housing Grant maximum went to $35,500 from $32,500 (one half the cost of the dwelling). VA doctors must approve the necessity of these grants and frequently the VA provides technical planning assistance for the veteran buyer/grantee.

Mr. Principi. I have a few questions. I will start with Mr. Doehler.

Mr. Doehler, at page 2 of its statement, the VA indicates that in fiscal year 1984 over 47 percent of all VA guaranteed loans were originated on the automatic basis whereby the loan originator rather than the VA, reviewed the income and the credit of the applicant prior to loan closing. Your statement seems to indicate that the mortgage insurers around the country have had some difficulty with this process and are perhaps shifting more to having the insurer review the credit application.

Would you please elaborate?

Mr. Doehler. Mr. Counselor, the answer really has to look at the function of mortgage insurance. I think we have to recognize that whether it's the VA program or any type of program that's not providing a 100-percent guaranty against loss, you have to anticipate that this program will operate with a small percentage of losses from a large pool of insured loans. When the mortgage insurance industry turned toward delegated underwriting and utilizing the lender to perform more of those underwriting functions, it was at a time where the marketplace was also incurring a number of problems. So, private insurers found that the lack of financial discipline or the need for financial discipline was increased during that period.

Now, the VA is a different type of program. The VA also must operate on a basis that they allow only a marginal number of losses but as a Government agency they certainly have a lot more controls than the private firms would have on the type of people they do business with.

In other words, the VA may have a completely different ability to control the losses on an automatic basis if they maintain eligibility requirements for participation by the lenders based upon lender performance. The success of automatic underwriting can best be determined by an analyis of losses. Our analysis of this underwriting caused us to terminate the programs.

Mr. Principi. Also, in your statement, you indicate that the VA may need to conduct more thorough investigations with regard to the decision whether to pay the claim or acquire the property—that is to say—the VA would lose more money by following the course of acquiring the property rather than paying the claim because there would be a high probability that the property may be more difficult to sell.

Mr. Doehler. The mortgage insurance companies have traditionally relied on a coinsurance principle. It's been basic to the way in which a private mortgage insurance company can do business. It means that we will provide a certain level of coverage, but it's loss protection only up to a level and then we participate or share the risk with the lender.

So, it provides the financial discipline—to use that word again—that the lender knows that there's going to be loss if he doesn't do good underwriting.

In addition, what we find is that if loans are being sold into the secondary market in great numbers and there's not the same degree of participation by the originator in the risk or if, for example, there is the selling of loan servicing—moving the servicing to different parts of the country—in other words, a loan originated in North Carolina becomes serviced by a large corporation out on the west coast.

The selling of servicing also adds to the problem of counseling, which I'm sure the Veterans' Administration has found as a serious problem in a number of its programs.

So, what we rely upon in this analysis of the settlement of a claim is this coinsurance principle. We approach a claim with the idea of having some mitigation of loss. If not, then we turn the property back to the lender and simply pay the coverage amount that is provided in the contract of the policy.

And, we found, in the last several years, because of the marketplace and because of the various lending practices that we are now taking title in order to mitigate our loss in probably 1 out of 15 cases, whereas you indicated earlier the VA is still doing 9 out of 10. We're glad that they're moving toward more taking of better—a more careful look at loss mitigation because it sets the standard for the lending industry.

Mr. PRINCIPI. And, you are acquiring 1 out of 15 properties?

Mr. DOEHLER. That's correct.

Mr. PRINCIPI. How much money do you lose on the properties in your inventory?

Mr. DOEHLER. We don't have the same disposition problem because in those situations you would only take title to properties that gave you a fairly good indication you would have a loss mitigation. In other words, the actual disposition of the property would bring in more funds than if you were to simply pay and write a check to the lender to make him whole or to provide him the benefit that's defined in the policy.

Mr. PRINCIPI. On the average, how long do you hold the property as opposed to the VA? Do you turn the property over right away, once you acquire the property?

Mr. DOEHLER. In fact, we've been working with lenders and we've got a number of programs up and running that have been supported by the secondary market agencies to work on presold plans. In other words, as a notification of default comes in, we begin right at that point working with lenders and their borrowers to try to work out a mutually beneficial arrangement.

So, the lender has less loss, and typically—and the mortgage insurer, of course, has less of a claim. But, sometimes early attention to delinquencies help because you find that an individual who is in the property is better served by moving to another location or finding some counseling that will help him get a clear credit rating, which is something of value to the consumer. If a foreclosure occurs an individual finds it has consequences beyond just losing the property.

Mr. PRINCIPI. We have some other questions we would like to submit for the record.

Mr. Wynn, the chairman discussed the issue of creative methods for financing as interest rates have increased. In the initial years of the mortgage, the interest rate is perhaps less.

When the mortgage banker considers a veteran's application for a loan with this type of financing, do you compare his or her income to the initial house payment or to the amount needed to make the higher payments when the higher rates come into effect perhaps 2 or 3 years down the road.

Is that a concern of your association?

Mr. **Wynn**. As Mr. O'Toole has previously mentioned, the guidelines that are followed are that we compare from a qualifying point of view, both the initial rate as well as the ability of that homeowner or potential homeowner to meet those increases as time goes by.

So, it's a combination of the two, and it certainly is a concern of lenders who do have risk in the VA programs that they are able in those buy-down cases to meet obligations as their payments rise over a period of time.

Mr. **Principi**. There also was some discussion this morning regarding the appraisals and the chairman pointed out that perhaps the lender should be doing the appraisals—assigning the appraiser—as opposed to the VA. Do you have any comments on that issue?

Mr. **Wynn**. I think that working with our task force, which has recently begun to meet and work with VA, that Mr. O'Toole has been promptly listening to those suggestions that we have and has already responded by a directive to his regional offices to allow the lender to have a copy of the appraisal which before we have not had.

I think this will allow us, over a period of time, to begin to provide more input into the questions that you've asked as we compare the quality of those appraisals as we see them with appraisals we receive, say, from our conventional type appraisers.

Mr. **Principi**. I ask on behalf of the chairman that you submit whatever recommendations you may have, not only for the VA, but to share the recommendations with the committee as well, so that we can benefit from them.

Mr. **Wynn**. Yes, sir.

[Subsequently, the Mortgage Bankers Association of America submitted the following information:]

MBA has had an ongoing Task Force on VA issues, which met recently with VA officials to discuss, among other issues, the problems surrounding the VA appraisal process. Three main areas were identified for reform.

First, MBA recommended that VA make a copy of the appraisal available to the lender for use during the underwriting review of the loan. This recommendation was subsequently adopted by the VA, effective April 12, 1985. Having a copy of the appraisal in hand during the underwriting enables the lender to identify questionable appraisals and order an independent appraisal, if necessary, to corroborate the conclusions of the original appraisal.

Second, MBA urges the use of the appraisal form utilized by the Federal National Mortgage Association (FNMA). The data collected on the VA appraisal form is insufficient in MBA's opinion and the FNMA form is more expansive. Because VA is required to use the same appraisal form as FHA, there would have to be a joint decision by FHA and VA to use the FNMA form. Currently, however, VA, FHA, FNMA and FHLMC are working together with various appraisal societies to develop a uniform appraisal form.

Finally, MBA seeks the establishment of a reporting system to identify unsatisfactory appraisers. At the time of foreclosure the name of the appraiser involved in the case should be identified, in order to determine if that appraiser's loans which end in foreclosure have consistently had significantly different (lower) values at the time of foreclosure than they did at the time of origination. Such a system would allow VA to police appraisers who were consistently in error, and would thus raise the consciousness of appraisers for the necessity of doing quality work.

MBA believes that taking these simple steps will enhance the operation of the Home Loan Guaranty Program and enable it to aid veterans to acquire homes they can properly afford and, by their service, have earned.

Mr. PRINCIPI. Also, Mr. Wynn, in your statement, when you mentioned the increase from 1 to 5 percent or 1 to 3.8 percent, you seemed to focus your concern on the fact that this was a tax. It was really not related to the solvency of the program. It was really a revenue raiser and not part of deficit reduction.

May I take that contention to mean that, if the fee was focused more on the solvency of the fund, that it was tied to the solvency of the fund, as has been recently proposed with this 3.8 percent phased in over 5 years with a triggering mechanism which the Administrator could adjust up or down, depending upon the program's losses, that proposal would be more palatable to your association and to you as a way of solving the shortfall in the reserve fund.

Mr. WYNN. Yes; we testified, as the original fee, the 1 percent fee that exists now, that while we were not in support of it, it should be directed to the VA program in order that it continue to be a viable financing tool.

We're not in favor of raising fees that would cause the program to be an unacceptable program for veterans or lenders. We feel that there are other avenues which this committee has so rightly recognized. It needs to be explored, as far as the efficiencies of the program. We feel that VA is receptive to exploring these avenues and making those justified changes.

At this point our position would be that perhaps an increased fee, beyond what is in place, is not needed and that other avenues of efficiency and approach will solve the problem.

Mr. PRINCIPI. One final question, Mr. Wynn.

I know your association will probably disagree with some of the statements that have been made with regard to the VA acquiring less properties from the lender and paying off the claim in more of those cases. How do you justify that position?

Mr. WYNN. Well, we feel that the way the procedure has been set up now, it has been a quota that has been set for the VA and perhaps not in regard to the actual financial facts. Also, as far as the lenders are concerned, the mortgage bankers are concerned, it's kind of changing the rules in the middle of the game.

We have never been put into position over the past years that this would be an alternative, although administratively I understand it could have been done. So, now we're faced with loans that we have made for many, many years in which there is now another risk factor involved.

So, if you are making it retroactive, as it has been done, then every percentage point that that mandate is ratcheted up increases our potential risk. Risks that we really didn't understand that we were going to have to have if we went into these older programs.

Mr. PRINCIPI. Thank you.

Mrs. Helfant, you talked about the need to increase the guarantee from $27,500 to, I believe, $35,000. But also in your statement, you recognize that the increase in the VA mortgage guarantee limit may also increase the VA revolving fund foreclosure risk.

At a time of insolvency in the program and foreclosures running at the rate of 2,000 a month, do you think that the committee should proceed along these lines when the program is experiencing such problems?

Mrs. **Helfant**. Yes; I do not think that denying the veteran purchaser who happens to live in California or other high cost areas the right to use his VA benefits is justifiably the reason to eliminate increasing the program. The fund does have problems, and those problems need to be solved. At the same time, we cannot penalize the veteran purchaser who happens to live in a high cost area of the country.

Mr. **Principi**. What recommendations might you have that could assist us in making recommendations or drafting legislation to have a better working relationship between the VA and the realtors in moving more of these properties? What should the VA be doing to sell this inventory that it is not doing right now?

Mrs. **Helfant**. We are beginning to review the process, the need process that VA has implemented in detail, and we are making some recommendations to you. We are very concerned that to process a million foreclosure properties is not competitive. Each of us in our business daily deal with relocation companies by which companies buy massive properties around the country by virtue of corporate relo.

We can deal in a matter of hours, usually no more than 24, from the time that we have a potential purchaser on the site to know whether we have an acceptable contract of sale contingent usually on financing.

However, in working with VA foreclosures, it is much of a bid process. A family who is coming into town or needs to relocate fairly quickly will put in an offer, go through the proper channels, and they may not know for weeks or even months whether they will secure that foreclosed property.

To us, that indicates that the inventory out there is not competitive. Nationwide it still tends to be a buyer's market, and the inventory just cannot be serviced quickly enough to respond to the buyer's need.

Mr. **Principi**. Do you think that we would get more realtor interest and participation if, rather than just an open listing, that we went to exclusive listings whereby a realtor, based upon some rotating list or bid process, could get an exclusive listing, would we get more interest by realtors?

Mrs. **Helfant**. I think that that is an alternative that needs investigation. Currently, VA pays a respectable fee to a marketing broker. That marketing broker has no in-house expenses to market that property. We have no advertising, we have no real expense of maintaining that in our office inventory.

So the fees seem not to be the problem nationwide. The problem seems to be the response time on do you have a sale, or do you not have a sale. There is no decisionmaking process that can respond quickly to an offer to purchase.

Mr. **Principi**. You seem to find the 3.8 percent phase-in period with the triggering mechanism much more palatable than the original proposal.

Is it acceptable to your association; and if so, or if not, do you see any diminution in the number of loan applications if you have this phase-in period of 2 percent in 1986 and 2.5 in 1987?

Mrs. **Helfant**. Philosophically, we oppose user fees. Realistically, we are Americans, and we understand the challenge facing our country. And each of us is American in deficit reduction. We feel that the fund should be self-sustaining. We do not like the idea of an increase. However, we view this program as a self-sustaining program and should be rather than as a subsidy program.

We have agreed to support the compromise that the administration has presented in the 5-year plan as long as there is a trigger mechanism involved. And that is speaking for the National Association of Realtors. That policy was adopted by our board of directors meeting in Washington 2 weeks ago.

Mr. **Principi**. Thank you, Ms. Helfant.

Mr. Smith, could you also please comment upon the 3.8 percent phase-in over 5 years as a mechanism?

Mr. **Smith**. We are certainly opposed to increasing user fees, because we are fighting a constant battle with affordability. Everytime you increase the fee, you price that many more people out of the marketplace—people who are then unable to afford our product.

You have got a problem, a serious problem. But I can submit to you as one who travels over the United States that we have builders in some areas who have not built a house in 4 years. And what do you think that they are competing against? They are trying to compete, and they cannot build because there is a high foreclosure rate in those areas.

This is a result of one of the most devastating recessions that the housing industry has had since World War II. And I can tell you that it has continued. Despite what you hear about how many housing starts there are across this country if you go up in the Northwest in Oregon, Wyoming, and Idaho, you cannot give those foreclosed homes away at any price. And the reason is because there is no employment there, there is no way to earn a living.

And it does not make any difference who has those foreclosed homes in inventory, the problems are not going to be solved overnight. It is going to take a long while. We also do not want to see housing costs go up anymore than they have already. We as an industry have worked very hard to lower housing costs. As a builder, I know today that my direct costs are less than what they were when I started in business. We are operating more efficiently. But if you want to attack the costs where they really are, look at excessive government regulation at the Federal, State, and local level.

This is where you will find increased costs in housing. We as an industry will always be reluctant to tack on user fees without looking at the underlying problems. I think that these problems can be solved. They can be solved by your committee, they can be solved by people sitting in this room, if we all sit around the table and address the issues. We have got a lot of smart people in the industry, the realtors, the mortgage bankers, the financial communities, and our industry, and I think that we can solve the problems. But they are not going to be solved easily, and we are all going to have to give a little bit.

Mr. **Principi**. Your industry, as you mentioned, during the recession has gone through some very difficult times. As we have discussed, it had to resort to certain creative financing, the buy-downs and things of that nature, to be able to market the properties.

Is this arrangement for financing reflected in the sales price; in other words, if a builder agrees to buy-down a mortgage over a 3- to 4-year period, does the sales price increase by a certain percentage to reflect those additional costs to you, and thereby be a negative equity in the home to the individual who purchases it veteran or nonveteran?

Mr. **Smith**. Our sales price is established by the surrounding market and whatever people are paying for housing in that particular area. If I put too many points in my sales price and put my price too high, I cannot sell my product. And in some cases, some of the points are included in the price. There is no question about that.

But if I price my product too high, I am the one who suffers, because I do not get sales. So I have to constantly be aware of what is happening in my local marketplace. I go by the price that is in that local marketplace. I have got to look at resales, I have to look at comparables, as Mr. O'Toole and others talked about today. I have got a whole variety of things that I have got to look at to establish that price.

And there are many cases where the traffic just will not bear the points that you are talking about, because you cannot get that price. And the last thing that I want to do is price myself out of the marketplace and have a house sitting there that I cannot sell. Because the end-product of that is that I am not going to make any money. And I am naturally in business to operate with a profit.

We are greatly concerned. That is why we are so concerned about the affordability of the product.

Mr. **Principi**. Thank you very, very much. I do regret that the chairman is delayed on the floor. I am sure that we will have another hearing on this matter. Thank you very much.

Mr. **Smith**. Thank you.

Mr. **Principi**. Excuse me one moment. Mr. Steinberg has a few questions.

Mr. **Steinberg**. Senator Cranston regrets not being here today. He obviously has had a chance to interrelate with many of you on different occasions before the Banking Committee.

First, I would like to thank Mr. Smith for his kind words about S. 9. We appreciate your support for that.

Mrs. Helfant, you supported the increase in the guarantee amount in your testimony, although you did not address any particular legislation.

Are you aware of S. 9?

Mrs. **Helfant**. Yes, we are, and we do support it.

Mr. **Steinberg**. The association does support that?

Mrs. **Helfant**. Yes. And that is the increase on the guarantee amount for veteran purchasers.

Mr. **Steinberg**. It also includes the adjustable rate mortgage provision as well.

Does your association have any position on that?

Mrs. **Helfant**. I chair the VA task force, and I am not familiar with the position, but I certainly will make sure that our staff provides that to you.

Mr. **Steinberg**. Thank you very much.

Mrs. Helfant, if you were personally advising a veteran who had come to you in connection with buying a house, and the 3.8 percent fee which under the administration's proposal could go into effect in 1990 were in effect, would you raise with that veteran questions of whether or not he or she might be better off choosing some other method of financing? What would your thought process be in terms of counseling the veteran?

Mrs. **Helfant**. Real estate professionals make their business by negotiating. And that is a concern now. Because we happen to be particularly in a market with over 117,000 active duty military which means that we are going to be turning a tremendous amount of property in the Hampton Roads area of Virginia.

We counsel today much in the direction because FHA happens to be also at 3.8 percent, and that is a factor in our market which we must address. However, if that were to occur in 1990, loans would be at 103.8 percent value at the time.

Therefore, the real estate professionals have to go back to renegotiate depending on the marketplace, either asking that the seller absorb those costs of the appraisal, or that they be handled in another manner. Or if there is a more viable approach to financing, a more competitive approach, to certainly recommend that. That is what we are in the business to do, to counsel our prospective purchasers on the best way for them to purchase.

Mr. **Steinberg**. It might become preferable at that point in terms of the overall economic interests of the veteran to try to go with a 5-percent downpayment and the purchase of private mortgage insurance.

Mrs. **Helfant**. Depending on the interest rate, the monthly payment, the marketability of the loan at the time of sale.

Mr. **Steinberg**. That would have to certainly be explored.

Mrs. **Helfant**. Certainly.

Mr. **Steinberg**. Is there anything about the current state of the loan guaranty fund as you evaluate it, based on what the association's position is, that leads you to support a doubling of the loan fee immediately in order to deal with any problems that the loan guaranty revolving fund may be having, since I understand that your position is to support a doubling of the loan fee effective October 1?

Mrs. **Helfant**. Around the country, our brokers and salespeople who market VA have expressed tremendous concern, and have been working with prospects. Of course, we have already had two increases or three, actually. It went from zero to a half to one.

Our people believe that the program is essential to provide housing to a certain segment of society that has no equity literally to put down. They are concerned that the program will continue to be in effect. They do not like and do not feel that perhaps that that is the best way of doing it. But they've evaluated and given us back the response that they feel that they can live with the program as presented under the administration's compromise provided that the trigger mechanism is built in, and the system itself is completely audited with an appropriate program to eliminate some of the inventory that is causing a tremendous drain on the fund today.

Mr. **Steinberg**. I understand that. What I am trying to ascertain is whether your support for the 2-percent fee is related to the needs of the revolving fund or the needs for deficit reduction. You spoke at some length eloquently about your responsibility as an American to deal with deficit reduction.

Mrs. **Helfant**. I think that they are tied together. The revolving fund is a drain on the national economy, and we have to look at it in that light. Therefore, it becomes part of the deficit reduction plan. We felt that we had to look at it in both lights.

Mr. **Steinberg**. Let me expand this to the rest of the panel. I think that you are all aware that there is a very large disagreement between the OMB estimate or the VA estimate, we are never quite sure whose it is, and the Congressional Budget Office estimate of the solvency of the loan guarantee program over the next 5 fiscal years.

Essentially, CBO, which projects that there is no solvency problem over the next 5 years, anticipates that the VA will be able to turn over its inventory at approximately the rate that it is turning it over and did turn it over in fiscal 1984. Therefore, receipts into the revolving fund would be sufficient to offset demands on that fund.

I would like to ask each of the witnesses based on your own personal expertise or the expertise of your organizations which of these estimates you believe is correct. We will start with Mr. Doehler.

Mr. **Doehler**. It is very difficult on a 100-percent loan program to make those kind of actuarial estimates using the experience of the mortgage insurance industry since we are limited to insuring the 5 percent down loans, as you have cited. I would estimate that given our fees right now on a fixed rate loan for a 5 percent down with say a 10-year term for insurance coverage, the premium would be in the range of 3 percent.

With that level of premium you would not be talking about making the VA revolving fund actuarily sound; that would probably take a substantially higher number. But to give an estimate as to which one is right, I would base my analysis on the level of losses related to underwriting performance if such data were available from the VA.

Mr. **Steinberg**. Fine. If you need to have copies of any documents setting forth those estimates, please let us know. Mr. Wynn.

Mr. **Wynn**. I think that probably as it has been said that both are educated guesses, because of the inability to accurately predict what will happen as far as foreclosures this year. However, I would hasten to say that I believe that with the efforts that are going on with the various task forces in each of our respective industries and VA's willingness to work with us, that we would lean toward the estimate that the existing guarantee will be sufficient to cover most if not all of any losses that might occur.

Mr. **Steinberg**. I would like to just reiterate what Senator Cranston said in his remarks and I believe that you were here. And that is that there will be approximately $200 million available over the next 3 or 4 fiscal years in the direct loan revolving fund which has traditionally been available for transfer to offset demands on the loan guaranty program as well. So it would not have to be solely the fee that would be responsible for dealing with the demands of the revolving fund. Mr. Smith.

Mr. SMITH. First of all, I think we have already addressed your questions on the CBO and administration projections on the VA fee in the budget on pages 3–7 of my testimony. But on the broader issue concerning deficits, the National Association of Home Builders was one of the first in the country whose officers traveled to bring this issue to the attention of the American public and who accepted major cuts in housing programs.

Now I think that it is about time that some of the other industries take their share of deficit reduction. I think housing has taken more than its share of deficit reduction, and I would urge Senators and Congressmen to look to industries other than just housing to reduce the budget deficit.

We went out and led the bandwagon on deficit reduction. We are committed to it. It is the No. 1 priority of the National Association of Home Builders. But there comes a time when you can only give so much blood, and I think that we have bled enough.

Mr. STEINBERG. Mrs. Helfant, do you have anything to add on that?

Mrs. HELFANT. No; I have nothing to add. We will have staff respond. Thank you.

Mr. STEINBERG. Taking off on the point that the mortgage bankers made or Mr. Wynn made in his statement in regard to the default rate on subsequent uses of a loan. I think that you called it a restoration guaranty.

Would you, Mr. Wynn, or any of the other members of the panel have any idea that you could share with the committee, first, as to why the second, third, or fourth subsequent uses are experiencing a higher default rate; and, second, as to why we saw between fiscal 1983 and 1984 such a very large jump of about 40 percent in the proportion of loans which are subsequent uses as compared to original uses?

Mr. WYNN. Those statistics that we have provided you have just surfaced in recent studies of delinquent statistics. We at this point do not know and it would only be speculation on our part to suggest why these percentages are as we have pointed out. Our staff is attempting to make some evaluations of that, and we will be glad to provide those to you as those evaluations are completed.

But all we know is that those statistics are there. We do not know why.

Mr. STEINBERG. Do any of the others of you have any comments to make on that, or would you like to study it further and share something with us?

Mr. DOEHLER. The restoration of the guarantee is not a practice in private insurance so I cannot comment.

Mr. STEINBERG. Tony, I think that it would be useful in that regard if we asked the VA to provide whatever comments they had on each of those two phenomena, that is the proportionate increase in foreclosures, and what appears to be a very large rise from 10.6 percent to 15.1 percent in 1983–84 in the percentage of loans, that are illustrative of these loans.

Finally, I wanted to ask the representative of the mortgage insurance industry if he would explain briefly how the fee structure works insofar as an upfront fee, a monthly fee, and how it is determined what portion of the loan amount would be insured.

Mr. DOEHLER. The traditional method used when fixed rate loans were predominant has been an initial premium and an annual renewal fee that was determined in the initial lender underwriting. Let us use the 5-percent down loan as the example. There would be a 1-percent fee at settlement for the first year. The annual renewal fee would be 25 basis points for the continuation of the coverage for as long as the lender wanted to have the loan covered.

A 10-percent down loan would typically have an initial fee of one-half a percentage point, 50 basis points, and then a 25 basis point renewal for the life.

There also developed a single premium where the insurer makes an estimate as to what a single premium would be needed in order to be profitable and operate an actuarily sound insurance fund. For example, make an estimate for a single fee upfront at the settlement for the life of the loan, or for a 10-year period.

Mr. STEINBERG. Could you give us a range of that?

Mr. DOEHLER. I would say right now. And I have looked at the 5-percent down loan for a 10-year term. In other words, the coverage would extend on the loan for 10 years. And the fee would be or the premium charged would be approximately 3 percent.

Mr. STEINBERG. That would be on a fixed rate loan?

Mr. DOEHLER. That would be on a fixed rate loan. It would be higher on adjustables. I cannot give you an actual quote. The trade association attempts to avoid all discussions of fees for obvious reasons.

Mr. STEINBERG. And the renewal of the ones that are not all paid for upfront, is it annual?

Mr. DOEHLER. That is an annual renewal, that is correct.

Mr. STEINBERG. So that would be for 10 years?

Mr. DOEHLER. The lender always retains I should say, the option to cancel the policy when he feels that the risk on the loan is sufficiently low. He can cancel the mortgage insurance.

Mr. STEINBERG. How about determining the portion of the loan that would be insured?

Mr. DOEHLER. Well, the coverage depth would also be set at the time the loan is underwritten. That would be a 25-percent coverage that I quoted at 3 percent for a 5-percent down loan. In other words, what they would do is add in all of the costs of the claim, and then the policy would say we will pay 25 percent of that total claim as a benefit to the lender.

Mr. STEINBERG. Is that traditional?

Mr. DOEHLER. Well, there are all different levels. There is a very, very wide range of pricing structures now within the industry. But that would be an example. If you were selling a loan specifically designed to go to one of the secondary market agencies, Fannie Mae and Freddie Mac, for example, there may be a type of coverage level that you would specify for the requirements that they have for purchase.

Mr. STEINBERG. I would like for you to respond to this if you wish and any of the other panelists.

In view of what appears to be a rather fundamental difference between private insurance and the Government guarantee which the VA provides—both in terms of the cost the smaller portion of insurance that is provided, and, of course, the 5-percent downpayments which is a requisite—how applicable is your experience in the private insurance field, and therefore how valid are some of your observations, in terms of what the VA is experiencing and how the VA Home Loan Program operates?

Mr. **Doehler**. Well, from the actuarial standpoint, there is a major difference between a no downpayment program which is the heart of the VA program, as you mentioned, and the 5-percent down. There are also other major differences on the underwriting side of it. The moral position that a veteran has always maintained in terms of paying his obligation is something different than what would be established generally in the conventional market.

And there are other basic underwriting approaches and practices that have been taken differently. But there are very many similarities at the same time. For example, the appraisal issue is a very important one for both the VA, FHA, and the private insurers as well as the secondary investors in mortgages.

And it is important that in any type of discussion of such things as appraisal practices or buy-down rate practices that the point be made that although only a very, very small percentage of those practices may be going on in the market, the financial consequence of that small percentage can be significant to an insuring fund. The key element to insurance is loss and if the VA and private insurers are suffering losses for the same reason then our experience is relevant to the VA.

Mr. **Steinberg**. There was a discussion earlier about a rather substantial disparity between the conventional foreclosure rate and the VA guarantee foreclosure rate. I take it that it comes as no surprise to you that the conventional foreclosure rate would be substantially lower.

Mr. **Doehler**. Well, the mortgage insurers when we looked at the unemployment graph that the Senator presented the trend that we have seen in terms of losses has been very similar to that of the VA. In other words, we have seen in this marketplace and predominantly because of inflation, as Mr. Smith from the homebuilders mentioned, we have a situation where in many markets unemployment may have come back in this recovery and maybe even incomes have come back to some extent in this recovery, but home prices have not again stabilized.

So there is a tremendous amount of competition out there. And there is the pressure from the homebuyer in considering the potential of foreclosure whether he can get enough from a sale in order to pay off the obligation and pay the selling costs in doing it.

Mr. **Steinberg**. The acceleration in your foreclosure rates is common to the acceleration in the VA's?

Mr. **Doehler**. They are very similar. I mean our losses, for example, as an industry in terms of just the dollar number, in 1980 as an industry, we paid approximately $58 million in losses. In 1984, we were about $472 million. So you can see that there is a tremendous jump.

The loss ratio is another indicator, and that basically is a percentage that relates to your earned premium. And in 1980, that was 18.9 percent, about 19 percent. In 1984, we were up around 74 percent.

Mr. **Steinberg**. Coming back for a moment to the initial question on this point that I asked, forgetting about the proportion of increase, but just looking at the rate of foreclosure now for conventional mortgages and the rate of foreclosure for VA guaranteed mortgages, it is in the nature of the beast that the foreclosure rate would be substantially lower in the conventional market.

Is that a fair statement?

Mr. **Doehler**. Well, I would say that a 100-percent loan by itself would require you to say yes, sure.

Mr. **Steinberg**. And 60 some percent of the VA loans are no downpayment loans?

Mr. **Doehler**. Exactly.

Mr. **Steinberg**. So it should be expected that there would be a sharp disparity?

Mr. **Doehler**. No question.

Mr. **Steinberg**. Whether it should be exactly as it is, that is another question.

Mr. **Doehler**. Well, the question is not only frequency in terms of defaults but severity, and that is an essential aspect of the program. You can look at the VA programs and say that the number of loans going to foreclosure is the equivalent or similar to the conventional side, but what are they paying per claim? Has the severity of loss per claim increased relative to private insurers? This answer has far more significance then similar numbers as to frequency of claim.

And that may be worth breaking that analysis out for the purposes of seeing whether there are any trends in the VA claims due to appraisals or due to other problems.

Mr. **Steinberg**. Mr. O'Toole, do we have data on the severity that could be given to the committee in that respect in terms of trends?

Mr. **O'Toole**. Yes, we have some of that. We certainly can identify what is happening.

Mr. **Steinberg**. If you could try to give us that data and working with whatever sources that you have in comparison to the conventional side, that would be very helpful.

Mr. **O'Toole**. Mr. Steinberg, we are trying to compare our loss of property and those sorts of things with some of the other large inventory holders, and whatever information we obtain.

Mr. **Steinberg**. That would be very helpful.

Do you want to comment on this?

Mr. **Wynn**. Yes. I think certainly that on the credit underlying any loan that there are certain guidelines which generally should be followed. And I think that VA tries to follow those, and tries to be consistent with those guidelines of FHA or the conventional lender.

I think that we would be remiss if we did not remind ourselves that the purpose of the VA Loan Guarantee Program to begin with in Congress' wisdom in 1944 was an attempt to provide partial payment for the veterans of World War II, and Congress in its wisdom continued to extend those benefits of veterans of the wars for the years that followed.

We would be remiss in not remembering that this program was set up initially as an entitlement program. That is not to say that VA or any lender who has the authority to approve a loan would make a loan knowing that that was going to be a bad loan.

However, because of that mandate, any comparison between an FHA loan and a comparison between a conventional loan necessarily is going to have some things that are going to differ. And I would think that that needs to be kept in mind during these debates.

Mr. **Steinberg**. Mr. Smith or Mrs. Helfant?

Mr. **Smith**. I think that you need to look at and analyze some of the causes of foreclosure and the types of loans that are most likely to default. There is no question that when you have a no-downpayment loan coupled with an environment of disinflation, that you are going to have problems with negative amortization.

And it is simply because there is no equity there. It is exactly what has happened in many parts of this country. There is not that increase and that appreciation in home buying that we had for many, many years, because inflation has been going down.

And now we find ourselves with people who have no equity and possibly negative amortization, and there is no incentive. You couple that with adverse economic conditions in some parts of the country and they have almost got to move from the area just to survive.

Mr. **Steinberg**. And that problem would be substantially aggravated by a large fee on top of the existing one?

Mr. **Smith**. It certainly would.

Mr. **Steinberg**. Ms. Helfant, do you have anything that you want to add?

Mrs. **Helfant**. Well, Mr. Steinberg, I think that it is important to say that over the past few years that with the recession that you have seen some strange things occurring. And of course, as part of our Nation changes from its industrial mode to a technical and service mode.

We have parts of the country where people did buy homes. They bought them. They were appraised well, and the realtors had no problems with the market. However, economic changes have closed the plant. Today homes that were appraised 5 years ago for a fair market figure are worth $10,000 to $15,000 less. Not because they were not fair market value at the time, but because of direct dramatic impacts on the locality.

So we feel that part of that will work by attrition, but we think that that very definitely has an effect on the increase in the VA foreclosure rates. Those people, those blue collars, are going to be the people who most likely are going to use their VA benefits, to use those benefits to buy their first home.

Mr. **Steinberg**. Thank you very much. I appreciate it.

Mr. **Principi**. The next panel will be Mr. Paul Egan, deputy director, national legislative commission, The American Legion; Mr. James Magill, assistant director, national legislative service, Veterans of Foreign Wars of the United States; and Mr. Stephen Edmiston, deputy national legislative director, Disabled American Veterans.

Thank you, gentlemen.

I regret the delay. We are almost there.

Mr. Egan, would you please begin.

TESTIMONY OF A PANEL OF REPRESENTATIVES OF VETERANS' ORGANIZATIONS CONSISTING OF: PAUL S. EGAN, DEPUTY DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION; JAMES N. MAGILL, ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES; AND STEPHEN L. EDMISTON, DEPUTY NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS

Mr. EGAN. We appreciate the opportunity to be here.

As you can see from the full text of our statement, we have undertaken a serious review of the VA Home Loan Program. What we offer is a conceptual framework for restoring the program to solvency, as well as its vitality.

In our judgment, the problems besetting the Loan Guaranty Program are much broader than the issue of pending guaranty revolving fund solvency.

True it is, the sale of VA's income-generating loan portfolio in 1983 and 1984, coincident with the recession and increasing rates of foreclosure, brought the program to the public view by raising debts concerning the VA's ability to meet its guaranty obligations.

However, other long-term problems, such as increasing property values, volatile interest rates—rates changed 16 times between 1983 and 1984—any imposition of user fees have frozen many veterans out of the home buying market.

In just 5 years, participation has dropped by 110,000. That represents a 35-percent decrease in participation, despite the fact that millions of Vietnam-era veterans comprise the "baby boom" generation, who are now at prime home buying age.

Just as these are among the most significant of the problems in the program, the solution holding the greatest promise must reverse these problems without threatening the legitimate interests of lenders, realtors, or others that play key roles in the housing economy.

The revolving fund must be made solvent, and veteran participation must be dramatically increased.

Interest rates must be made affordable for first-time homebuying veterans, and added assurances that veterans are good mortgage risks must be provided.

To accomplish these ends, we encourage the committee to consider accelerated VA direct loan activity to rebuild the VA's income-generating loan portfolio, a special mortgage program for first-time home buyers offering increases in guarantees in exchange for lender reductions in interest rates, veteran-purchased mortgage insurance protection against short-term economic reversal instead of user fees, lender refinancing in lieu of foreclosure under certain circumstances, and the addition of a new section in title 38 codifying many of the nonbinding provisions of the VA Lenders' Handbook.

Now, that summarizes our statement. There are several facets to the proposals we've laid out in our statement. In the interest of time, however, I will defer to your questions on our recommendations.

Mr. PRINCIPI. Thank you, Mr. Egan.

[The prepared statement of Paul S. Egan, deputy director, national legislative commission, The American Legion, follows:]

PREPARED STATEMENT OF PAUL S. EGAN, DEPUTY DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION

Mr. Chairman and members of the Committee, The American Legion appreciates this opportunity to present its views on the VA home loan guaranty program. At the outset we feel compelled to state that in our judgement the VA home loan program ought to be the very best housing program in the country; a model to be emulated by other federal and state programs. Sadly, this is not the case. There are in fact several home loan programs operated by individual states which are both more efficient and more beneficial to veterans than the VA program.

A notable example is the program operated by the state of California. Known as the "Cal Vet" program, veterans using it are permitted to purchase single family dwellings up to a maximum value of $75,000 with 30 year fixed mortgages bearing maximum interest rates of 8 percent. That program is supported by state sales of tax exempt General Obligation and Revenue Bonds. In essence, the state purchases property for the veteran and the veteran repays the state through a mortgage lender.

We cite the example of the Cal Vet program because it, although smaller in scope than the VA home loan program, is a shining example of a consistently stable program. In spite of numerous ups and downs in the national economy since the Cal Vet program was begun on July 1, 1922, it has remained viable and has made over 369,000 loans valued at over $6.5 billion.

The American Legion believes the VA program too can be returned to self sufficiency, obviating the need for either user fees or direct appropriations to cover shortfalls in the Loan Guaranty Revolving Fund (LGRF). In essence, we wish to discuss five points designed to revitalize the VA home loan program. In our opinion, these points constitute a proposal which reasonably addresses the concerns of veterans who are contemplating home purchases, as well as the concerns of lenders and realtors who continue to participate in the VA home loan program.

Before proceeding, however, it would be appropriate to briefly digress for the purpose of examining the history of recent changes in the program which have brought the program to its current state of near insolvency. In 1983 a change was made in the VA home loan program which accelerated the drain on the LGRF, necessitating direct appropriations in 1984.

The reconciliation act of 1983 required VA to sell its portfolio of direct or vendee loans. Though immediate and short term savings were projected, this move was highly disruptive of LGRF stability. Without the portfolio of VA loans, VA was unable to utilize its assets to meet guaranty obligations at precisely the same time that foreclosures were increasing dramatically due to the nation's most recent deep recession.

At the time, it was projected that sale of the portfolio would generate $968 million in revenues which would go to the Treasury and miscellaneous offsetting receipts. In actuality the sale in 1983 of portfolio loans netted the Treasury only another $853.7 million. On balance, even though less revenues than projected were realized, the 1983 and 1984 sales of VA loans generated funds for the Treasury amounting to $1.5 billion. Given the size of this figure, and the interest that would have accumulated, it is clear to us that sufficient assets could have been produced to cover LGRF shortfalls created by high foreclosure rates if the VA had been permitted to maintain and properly manage its loan portfolio.

Another problem, and certainly not the least by any means, concerns veterans participation. For the last several years as property values have escalated and interest rates have fluctuated wildly, thousands of would-be buyers have been unable to afford home ownership. Home loan closings in 1984 were more than 110,000 below the level five years earlier, despite the millions of Vietnam era veterans comprising the baby boom generation who are now at prime home buying age.

Yet another problem may have arisen because veterans over the last few years have been more than willing to contribute in efforts to bring the federal budget under control. Generally the veterans community agreed, albeit with great reluctance, to the imposition in 1983 of a ½ percent user fee and the later increase to 1 percent in 1984. The proceeds of this fee are now being redirected from the Treasury to the LGRF because of the LGRF deficit, but higher fees mean more expensive housing for veterans -- exactly the opposite of what is needed to increase veteran participation.

In summary, the problems besetting the home loan program include LGRF insolvency due to ill advised sale of the home loan portfolio, lagging participation by veterans unable to afford use of the program, high property values, high interest rates and added disincentives for use of the program caused by user fees. Just as these are but a few of the problems with the program, the solution holding the greatest promise of restoring the program must reverse many of these problems without threatening the interests of lenders and realtors.

The LGRF must be made solvent and veteran participation must be dramatically increased. Interest rates must be affordable and added assurances that veterans are good mortgage risks must be provided. To accomplish these ends we encourage the Committee to consider accelerated VA direct loan activity, a special mortgage program for first time home buyers, mortgage insurance protection against short term economic reversal, lender refinancing in lieu of foreclosure under certain circumstances and the addition of a new chapter of title 38 codifying many of the non binding provisions of the VA Lenders Handbook (VA Pamphlet 26-7 Revised).

The first of these is designed to rebuild the home loan portfolio that was truncated in 1983 and 1984, but which is so critically important to restoring solvency to the LGRF. It is our understanding that VA will possess some 19,8000 properties in its inventory of properties acquired through foreclosure by the end of fiscal year 1985. Recognizing that each of these properties can be put up for sale by the VA's direct loan vendee program at interest rates even lower than the maximum rate set by the Administrator, we believe VA should proceed to do so aggressively.

To expedite the sale of these properties, it is further recommended that the policy that vendee properties be sold only through real estate brokers be modified. Were VA to sell these properties directly to veterans without brokers, the 5 to 6 percent fees of brokers could be saved and passed on to the buyer in the form of 5 to 6 percent reductions in property costs. Alternatively, if the VA found that its properties could be moved more quickly by applying the 5 to 6 percent savings to lower interest rates or to offsetting discount points paid by the buyer at the time of sale, VA should do so. Additionally, we see no good reason why the existence of VA held properties is so generally unknown to the public at large. To further expedite sales, VA should advertise its properties in newspapers and other appropriate media outlets just as any other seller would.

Importantly, this is not to say that realtors should be denied access to sales of VA properties. That certainly should continue. We do believe, however, that direct VA sales and aggressive advertising would augment the existing mix of commission bonuses, discounts for cash sales, and other incentives pertaining to hard-to-sell properties.

A second point deserving the Committee's attention would be designed to make the home buying market more accessible to veterans, and to generate expansion of LGRF assets. While primarily directed toward the interests of veteran home buyers, it seeks lender participation through guaranty adjustments and the probability of greater volume of mortgage applications.

In essence, first time home buying veterans would be able to purchase housing with 30 year fixed rate mortgages at interest rates significantly below the maximum rate set by the Administrator. Mortgage lenders would be offered incentives to reduce interest rates in exchange for incremental increases in the VA guaranty up to a maximum of 60 percent. Because of relatively low rates on these loans, it might be necessary to insure lender interest by marking these mortgages non-assumable. Since the average length of time a veteran holds a mortgage is only 13 years and since the guaranty VA would provide could be substantially higher than under normal circumstances, thereby making the mortgage much more secure, lenders should be willing to participate in this program even though the interest rates on these mortgages would be considerably lower than prevailing market rates.

There are still other incentives for lender participation which will be discussed below, but the basic mechanism permits lenders to "buy down" the level of interest in exchange for increased guaranties. Perhaps, a maximum mortgage value of $100,000 (or a lower amount) should be established in order to recognize the limited resources of the first time home buying families.

Under this proposal, the current guaranty of the lesser of $27,500 or 60 percent would be modified. Instead, a base guaranty of $27,500 would be used. For example, a veteran is seeking to purchase a home costing $68,750. The VA set interest rate is 12 percent and $27,500 represents 40 percent of the purchase price of the home. In order to make the property affordable, the banker would be permitted to increase the guaranty in four 5 percent increments up to a maximum of 60 percent in exchange for reducing the interest rate on the mortgage by 1 percent for each 5 percent incremental guaranty increase. In this example, the veteran could obtain a 30 year fixed rate mortgage bearing an 8 percent rate. The banker in this example could avail himself of a much more secure loan owing to the increase in the guaranty and the veteran's enhanced ability to be reasonably expected to meet mortgage obligations affordably.

In that regard, the financial circumstances constraining many would-be first time home buyers cannot be overemphasized. Under the existing porgram the same veteran seeking a mortgage on a $68,750 home would be required to pay a 12 percent interest rate and the same lender would be limited to a 40 percent guaranty. Reductions in interest rates would permit substantial monthly savings for the veteran. The chart below using a loan value of $65,000 vividly demonstrates the monthly savings possible and strongly suggests the enhanced affordability of housing if interest rates were reduced.

PERCENT	LOAN VALUE	RATE	PER THOUSAND	MONTHLY PRINCIPLE AND INTEREST
14%	$65,000	30 year fixed	$12.09	$785.85
13%	$65,000		$11.19	$727.35
12%	$65,000		$10.20	$668.45
11%	$65,000		$ 9.53	$619.45
10%	$65,000		$ 8.78	$570.70

At the outset of discussion about this idea to make housing more affordable, it was stated that this special program could also foster dramatic growth in VA home loan assets. Both the LGRF and the Direct Loan Revolving Fund (DLRF) could become growing resources for veterans desiring to purchase homes if two additional facets were added to the special first time home buyer proposal. The first of these facets would authorize VA to purchase the low interest loans from lenders having written these special mortgages. The second facet would authorize VA lending on properties other than those in its inventory of foreclosed properties.

By authorizing VA to purchase these special low interest mortgages from the lenders having written them, the process of rebuilding VA's loan portfolio would be dramatically accelerated. This added authority can also be expected to serve as as additional incentive for lenders to write these mortgages. Additionally, those mortgages purchased by VA would serve as money generating assets further assisting the growth of available funds in the DLRF and for any necessary transfer to the LGRF. Consideration might also be given to VA's authority to assemble these mortgages into pools of mortgage backed securities and sold to investors desiring lower yield but sound investments offering long term stability.

The other facet deserving your committee's consideration would involve using the banking community for the purposes of writing and servicing VA loans, allowing lenders their usual fees and sparing VA the need for enlarged FTEE levels in its Department of Veterans Benefits (DVB). Moreover, the veteran buyer would pay the banker and the banker would transfer the funds collected to the DLRF. As with the low interest mortgages written by bankers using their own funds and purchased by VA for its DLRF portfolio, mortgages written by bankers with VA funds would generate interest for VA and expand VA's assets. These loans too could be pooled and sold to investors in mortgage backed security instruments if needed.

This pooling and selling of mortgage securities might be perceived as constituting federal competition with private sector mortgage backed security institutions such as Ginny May, Fannie Mae, Freddie Mack or others. It must be noted, however, that the yield on these special mortgages would be lower than more traditional securities.

Before leaving this proposal and moving on to the next, there is a question which can be anticipated that must be answered. How will start-up funds be made available to carry out this program of lending and loan purchasing in these times of extreme fiscal restraint? A special series bond is one option, and examining the temporary availability of some unobligated resources could be another.

Obviously, this discussion of a special initiative to attract first time veteran home buyers contains several items which, if seriously considered by Congress, would involve the granting of greater VA authority to administer and manage its home loan program. Some people may view this discussion as a significant departure from the current method of operation, but we see the first time veteran home buyer as one who deserves special consideration under the program and one whose financial needs must be the principal focus of any efforts to modernize the program. Based upon this committee's long standing interest in the program, we expect that you also recognize the need for basic program changes to re-establish its former attractiveness and its financial viability.

If this committee, during its deliberations on developing a method to attract first time buyers by offering below market interest rates, feels that an additional lender incentive would be appropriate, there is the option of making such special loans non assumable. This, of course, observes the average 13 year duration of VA loans, and it would afford some protection against relatively low return on more extended period loans.

The third principal point presented for the Committee's consideration is related to the second. It would offer further incentives for lenders to participate in the special first time home buyer program by making these mortgages more secure and it would replace user fees for first time home buyers. In essence, home buyers would purchase mortgage insurance from VA to protect against short term economic reversal. At the time of closing on a property, the veteran buyer would be obligated to pay a small one time premium -- perhaps, 1percent. This premium could be amortized over the life of the mortgage just as with the current user fee, but instead of the user fee. The banker would then transfer this premium to the VA where it would be deposited in a new revolving fund, a Mortgage Insurance Revolving Fund (MIRF).

If after having purchased this insurance the veteran encountered a short term economic set-back resulting from divorce or employment layoff, for example, the MIRF would supply funds to partially cover mortgage payments for 6 - 9 months until the veteran got back on his economic feet by taking on a renter, returning to work or perhaps even selling the property. This type of plan would further protect the lender's investment against foreclosure as well as protect VA's guaranty. Moreover, a plan of this nature can be seen as a preventive alternative to home loan foreclosure relief initiatives such as those passed by the House of Representatives during the 98th Congress.

This mortgage insurance program option could and should also be extended to veterans refinancing existing home loans aiming to take advantage of reduced VA interest rates and to veterans desiring to refinance in the face of foreclosure.

Providing this insurance to those refinancing loans should be seen as another means toward reducing future risks of foreclosure or default.

A fourth item would be aimed at reducing the number of foreclosures in the future. For veterans finding themselves in financial difficulties of a more long term or severe nature, the VA and lenders should develop a program of refinancing in lieu of foreclosure providing certain criteria are met. Such a program should allow the veteran to refinance not only the loan but the delinquency penalties as well. This would make refinancing more affordable by freeing the financially troubled veteran from the up-front penalty obligation. As with the first time home buyer using the special mortgage plan, these veterans too should be exempted from user fees.

The refinanced interest rate would reflect the greater of either the then existing rate on the mortgage or the currently prevailing maximum rate set by the VA Administrator. In return for this, lenders would be required to forego up-front discount point charges that are ordinarily required on refinanced loans. This might make it possible for veterans to affordably refinance without acquiring additional debt.

As for the conditions to be met in order to benefit from this refinancing program, the Administrator would have to make a determination that the foreclosure proceedings or default were not the result of willful misconduct by the veteran. Also, the Administrator, through regulations developed by the VA, would have to certify a reasonable probability that the veteran would be restored to sound financial footing.

A fifth matter for consideration by the Committee would involve an adjustment in title 38, United States Code for the purpose of codifying a variety of VA's non binding recommendations to lenders contained in the VA Lenders Handbook. This would apply the force of law to VA and lender practices, particularly with regard to section F of the Lenders Handbook relating to forebearance procedures.

Finally, a few other examples of matters we believe are in need of codification are worth noting. A sound policy of loan qualifications should be established to prevent home buyers from entering into obligations they cannot meet. In years gone by, a basic rule of thumb generally observed by both buyers and lenders was that no more than 25 percent of gross income should be devoted to housing. With property values having escalated and interest rates having fluctuated erratically (16 times between 1983 and 1984), veterans have had to consume much higher percentages of disposable income in order to purchase a home. Changes in interest rates have created a climate conducive to jumping into the market imprudently in order to take advantage of declining interest rates before they go back on the rise. Given the realities of contemporary housing conditions, we suggest that a more reasonable relationship be established between net disposable income and the monthly mortgage payment. Were this qualification criterion strictly enforced over recent years, it is likely that many fewer veterans would have found themselves facing foreclosure.

Similarly, VA should be prepared to enforce the law by reviewing and evaluating lender practices. Those lenders out of compliance should be denied the opportunity to take advantage of VA guaranties.

Another example would require VA to establish a vigorous inspection program for used dwellings, accompanied by strict appraisal standards to afford veterans the maximum protection against "over pricing". Unless used housing meets certain criteria, to be established by VA, no loan guaranty should be provided. As with poor qualification of a veteran's debt to income ratio, many veterans have undoubtedly defaulted on home loans due to unanticipated renovation expenses.

Additionally, the Administrator should be empowered to refuse a housing guaranty for any seller refusing to warrant, in writing, all claims to the condition and age of the property. Such a seller's warranty to the buyer would provide veterans with some reasonable recourse and would go far toward discouraging misrepresentation of condition and age of property conveyances.

Mr. Chairman, we believe the home loan program is in serious trouble, and fundamental changes should be considered. The ideas presented are offered in the spirit of presenting the Committee with a conceptual framework from which to begin a meaningful dialogue on how to restore the program to its historic vitality.

Mr. Principi. Mr. Magill.

Mr. Magill. Thank you for the privilege of appearing before this committee to present the views of the Veterans of Foreign Wars with respect to the VA Home Loan Guaranty Program.

As we have testified before, we believe the VA Home Loan Guaranty Program is one of the most successful and beneficial VA programs available to veterans. Clearly, a vast number of veterans would not be in their own homes today if it were not for this program. We believe the VA Home Loan Guaranty Program should continue to enjoy the full support of both the Congress and the administration.

It is a matter of record that the Veterans of Foreign Wars strongly opposed the implementation of the user fee for a VA-guaranteed home loan. Therefore, we are, of course, in opposition to any increase in that fee. We believe that such an increase would further constitute a discriminatory tax.

We are also against repealing the Veterans' Administration's current authority to establish a home-loan rate.

The question still remains as to why, over the past few years, a period characterized as one of general economic recovery, the VA foreclosure rate has remained high. We believe there are many factors responsible for this.

And again, in order to save time, they are spelled out in my testimony, so I won't go into them right now.

We also believe the VA Home Loan Program can stand some refinement with respect to the program's solvency. There are, in our opinion, two main objectives to be achieved: Reducing the number of foreclosures and improving the handling of defaulted properties by the VA.

With ~~respect~~ to reducing foreclosures, we believe that veterans should be extended periods of grace and receive priority assistance from the VA in order to make their mortgage payments and retain their own homes.

We would also recommend that the VA be notified when a mortgage payment is 1 month overdue, rather than after 3 months, which is, as I understand it, the practice right now.

We also believe that considerable improvement can be made in the manner in which the defaulted properties are handled. It is very important to reduce the amount of time the real property is held by the VA.

Finally, I would like to offer recommendations which we believe would enhance the program's operation.

The VFW strongly believes that all veterans with service-connected disabilities should be eligible for mortgage insurance assistance.

We also support raising the maximum entitlement available for the purpose of purchasing a manufactured home to the same level as that permitted for other types of dwellings.

This concludes my statement, and I'll be happy to respond to any questions you may have.

Mr. Principi. Thank you, Mr. Magill.

[The prepared statement of James N. Magill, assistant director, national legislative service, Veterans of Foreign Wars of the United States, follows:]

VETERANS OF FOREIGN WARS OF THE UNITED STATES

OFFICE OF THE DIRECTOR

PREPARED STATEMENT OF JAMES N. MAGILL, ASSISTANT DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

Thank you for the privilege of appearing before this distinguished Committee to present the views of the Veterans of Foreign Wars of the United States with respect to the Veterans Administration Home Loan Guaranty Program.

The VFW is appreciative of the Chairman for holding this hearing, demonstrating his and the Committee's continuing concern for our Nation's veterans being able to attain the American dream of home ownership.

In our view the VA Home Loan Guaranty Program is demonstrably one of the most successful and beneficial VA programs available to veterans. More than eleven million loans have been approved to date, thus attesting to its great popularity and viability. As to the necessity of this program, there can also be no doubt. Approximately 64 percent of all VA guaranteed home loans are made without a down payment, something which is not generally possible with conventional loans, showing that many veterans choose this type of financing precisely

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for this benefit which would not otherwise be available. Clearly, a vast number of veterans would not be in their own homes today if it were not for this program. We believe the VA Home Loan Guaranty Program should continue to enjoy the full support of both the Congress and the Administration.

Mr. Chairman, it is a matter of record that the Veterans of Foreign Wars strongly opposed the implementation of the "user fee" for a VA guaranteed home loan. Therefore, we are of course in opposition to any increase in the fee. We hold that any such increase would further constitute a discriminatory tax, and work both to the veteran's and the home loan program's detriment. We are also against repealing the Veterans Administration's current authority to establish a home loan interest rate. We are convinced that departing from this policy would be a serious mistake, working against the veteran's best interest and seriously jeopardizing this most beneficial program.

Mr. Chairman, the question still remains as to why over the past few years, a period characterized as one of general economic recovery, the VA foreclosure rate has remained so high. We believe one contributing factor is the current high rate of divorce in this country. Through divorce, a two-income family is at once torn in two and a mortgage payment that was formerly easily met can no longer be paid. Further, an impending divorce is not something which can be easily discerned in advance from a veteran's financial statement or credit record. Thus, once healthy loans suddenly go into default. However, it must be pointed out that this program is occurring throughout the Nation and is certainly not peculiar to veterans or VA loans.

The high rate of foreclosures is, we believe, also largely attributable to a two-part lag in this Nation's financial mending. The first such lag occurs at the regional level. That is, whereas some parts of the country have fully recovered from our most recent recession and are indeed prospering, there are still others throughout the Nation that have yet to reexperience financial health, and a great number of VA defaults are occurring precisely within these depressed regions.

There is also a second lag occurring within the overall national economic recovery. This one occurs at the individual level and may have an even more detrimental affect on the VA Home Loan Guaranty Program than the first. Even within economically prosperous regions there are individuals, veteran borrowers, who have yet to regain their financial strength. Veterans who are still unemployed, underemployed, or only recently reemployed are certainly in this category. Also, there are veterans who, say, once earned ten dollars an hour working in heavy industry or construction but who are now only making five dollars an hour as service industry employees. All of those veterans who fall under the unfortunate axiom "first fired last rehired" must also be of consideration. These are all precisely the individuals who have most overextended their resources and credit so that their financial health--their ability to make a hefty mortgage payment--lags far behind that of the rest of the Nation.

For the most part, these veterans will recover--but they need time. So it is our contention that the authority of the Administrator to assist veterans in keeping their homes should be greatly expanded, and that this authority should be liberally exercised. We believe that such a judicious exercise of sufferance and patience will greatly contribute to achieving our common goal--veterans living in their own homes and a financially healthy Home Loan Guaranty Program.

However, this is not to suggest that there is not room for improvement. The VA Home Loan Guaranty Program could well stand some refinement. With respect to the program's solvency, there are in our opinion two main objectives to be achieved--reducing the number of foreclosures and improving the handling of defaulted properties by the VA.

With respect to reducing foreclosures, we believe that veterans should be extended periods of grace and receive priority assistance from the VA in order to make their mortgage payments and retain their own homes. Both the veteran and, ultimately, the VA Home Loan Guaranty Program would benefit. We would also recommend that the VA be notified when a mortgage payment is one month overdue rather than after three payments have been missed as is currently the practice. This, in many cases, would allow for successful remedial action before a loan is irredeemably in default.

Mr. Chairman, we also believe considerable improvement can be made in the manner in which defaulted properties are handled. It is of tantamount importance to reduce the amount of time real property is held by the VA. Real property is very expensive to hold since the VA must pay taxes on all such property in its inventory, as well as securing it against vandalism and weather. Although the current decline in interest rates and improving economy should increase VA property sales, new and more aggressive marketing techniques could further enhance such activity. Another possibility would be for the VA to sell some of its holdings directly instead of exclusively through brokers as is the current practice. Additionally, since a long-holding time for certain properties may sometimes be forecast upon acquisition, it may be better to drastically discount them immediately in order to achieve quicker sales. Perhaps those holdings deemed most difficult to sell could be both very drastically discounted and then sold without recourse so as to move them expeditiously and reduce the VA's financial exposure. Finally, increased auctioning of such properties might also decrease holding time.

Mr. Chairman, the manner in which property is acquired should also be scrutinized. A provision of Public Law 98-369 requires that property be acquired on a case-by-case basis, that is, the VA may not acquire property when costs would be in excess of the amount liable under the guaranty. This has already resulted in a decrease of acquisitions from 95 percent to 89 percent. With the enactment of this law, savings were projected to be in excess of $158 million annually. Vigorously pursuing this case-by-case approach may result in even greater savings.

Another means of enhancing the VA Home Loan Guaranty Program's assets could be by increasing its portfolio of vendee loans--since they generate revenue in the form of principal and interest payments. Additionally, funds generated by assets sales enter the Loan Guaranty Revolving Fund (LGRF) as offsetting collections, which offset obligations and, correspondingly, outlays.

At this juncture, Mr. Chairman, it should be noted that the CBO (Congressional Budget Office) now estimates that under current law the LGRF could sell sufficient assets to meet its projected deficits through 1990, this would eliminate the need for appropriations during this period, and is certainly a powerful argument against any increase in the user fee on vendee loans since the VA's effort to pursue this beneficial course would be impaired, reducing sales and thereby resulting in greater cost to the government. Further, it may be readily inferred from the CBO estimate that although the VA Home Loan Guaranty Program has encountered financially troubled waters, the mechanisms required to keep it afloat and on course are essentially well in place. This program has not only been advantageous to veterans but also to the Nation as a whole. It has been shown the VA Home Loan Guaranty Program contributes more to the economy than it takes out by providing a source of credit without which the building industry would surely languish. We are adamantly against implementing any rash proposals which would severely alter its character and serve only to the detriment of this valuable program because of temporary financial difficulties. We must make improvements, but only with the utmost caution and care.

With this in mind, we would now offer several recommendations which we believe would enhance this program's operation and the service it provides veterans. The VFW strongly believes all veterans with service connected disabilities, not just those who have been authorized specially adapted homes, should be eligible for mortgage life insurance assistance. Currently, many disabled veterans are classified as uninsurable and denied this protection by commercial insurers, while others are prevented from obtaining it due to the exorbitant premiums required.

The VFW also favors veterans being afforded the option of using buyer brokers when buying a home. This would result in decreased costs to the veteran and also to the VA since foreclosure would consequently decrease. We also support raising the maximum entitlement available for the purpose of purchasing a manufactured home to the same level as that permitted for other types of dwellings. With the rapidly escalating cost of housing today, manufactured homes are often all that a veteran can afford. Additionally, since a VA loan may now be granted for both the manufactured home and the lot, a higher entitlement is certainly needed. Finally, it is our opinion that the Administrator should exercise greater latitude in setting the VA Home Loan percentage/maximum amount so as to maintain this program as the most viable and desirable means of home financing available.

In considering the current status and functioning of the Veterans Home Loan Guaranty Program, the delegates to our most recent National Convention adopted Resolution Nos. 612 and 615 which are appended to our testimony, and we urge your careful consideration of the recommendations therein.

Mr. Chairman, this concludes my testimony. I will be happy to respond to any questions you may have.

Resolution No. 612

MORTGAGE INSURANCE FOR DISABLED VETERANS

WHEREAS, veterans, because of their service-connected disabilities, may be denied mortgage life insurance protection by being classified as uninsurable by commercial insurers; and

WHEREAS, veterans because of their service-connected disabilities, may be required to pay higher premiums for such insurance; and

WHEREAS, only veterans who are entitled to specially adapted housing are currently eligible for such insurance assistance; and

WHEREAS, we believe that service-connected veterans should not be required to pay higher premiums or be denied such insurance protection for the benefit of their families; now, therefore

BE IT RESOLVED, by the 85th National Convention of the Veterans of Foreign Wars of the United States, that we seek the introduction and passage of legislation that will provide for relief from higher insurance premiums or for mortgage life insurance for service-connected disabled veterans.

Adopted by the 85th National Convention of the Veterans of Foreign Wars of the United States held in Chicago, Illinois, August 17-24, 1984.

Resolution No. 612

Resolution No. 615

VETERANS ADMINISTRATION HOME LOANS

WHEREAS, current law provides that Federal Housing Administration (FHA) loans will bear a local buyer/lender negotiated rate of interest instead of a nationally fixed rate; and

WHEREAS, such may serve to make Veterans Administration (VA) fixed rate home loans less attractive to sellers and lenders; and

WHEREAS, VA home loans are a substantive part of the benefits "package" afforded those who have honorably served their nation in the Armed Forces; and

WHEREAS, the maintenance of a competitive and viable VA home loan program is very necessary in order for veterans to continue to receive meaningful benefits in recognition of their service; and

WHEREAS, changes in the VA home loan program such as granting the VA Administrator the ability to (a) independently set VA home loan rates; (b) exercise greater latitude in the VA home loan guarantee percentage/maximum amount; (c) authorize veterans the option to engage the service of a buyer broker; (d) authorize the subsidization of VA loan interest rates, and other program improvements, may strengthen that program, now, therefore

BE IT RESOLVED, by the 85th National Convention of the Veterans of Foreign Wars of the United States, that we seek the introduction and passage of legislation that will serve to maintain the VA home loan program as the most viable and desirable means of home financing available.

Adopted by the 85th National Convention of the Veterans of Foreign Wars of the United States held in Chicago, Illinois, August 17-24, 1984.

Resolution No. 615

Mr. PRINCIPI. Mr. Edmiston.

Mr. EDMISTON. Thank you. It's a pleasure to be here on behalf of the more than 1 million members of the DAV to comment on the VA Home Loan Guaranty Program.

There is no doubt that this program has been a good investment in America. It has helped millions of veterans and their families become homeowners.

Additionally, the program has also played an integral role in the growth and expansion of the housing and financial industries in our country.

Rather than specifically summarize my testimony, let me just say that the DAV concurs with some of the views the chairman set forth in his opening statement—that is to say we believe it is appropriate to address the problems of the program by identifying them and correcting them administratively and get the program back on its feet.

We believe this approach is far more realistic than increasing the users fee.

And in closing, we would urge the committee members to continue their strong support of the program to ensure that veterans will have a program that they can benefit from.

Thank you.

Mr. PRINCIPI. Thank you very much.

[The prepared statement of Stephen L. Edmiston, deputy national legislative director, Disabled American Veterans, follows:]

PREPARED STATEMENT OF STEPHEN L. EDMISTON, DEPUTY NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS

Mr. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

On behalf of the more than one million members of the Disabled American Veterans, may I say how very much we appreciate the invitation to appear here today to comment on the VA Home Loan Guaranty Program.

At the outset, Mr. Chairman, the Disabled American Veterans wishes to commend you and the members of the Committee for this timely exercise of your oversight responsibilities in reviewing this important VA benefit program.

VA HOME LOAN GUARANTY PROGRAM

As you know, Mr. Chairman, the purpose of the VA Home Loan Guaranty Program is to assist eligible veterans in obtaining mortgage credit for the purchase of existing or manufactured homes and construction of new homes without a down payment.

There is no doubt that the VA Home Loan Guaranty Program has been a good investment in America. It has helped millions of veterans and their families become home owners -- thereby adding stability and expanding the tax base of nearly every community in our country. Since the Program's inception on June 22, 1944, veterans have obtained over 11 million VA guaranteed home loans.

Veterans' use of the VA Home Loan Guaranty Program -- like private sector housing programs -- is subject to and directly related to general economic conditions and, more specifically, to conditions in the financial and housing markets.

As we all know, within the past five years, the housing and financial markets have experienced shortages of mortgage funds, increased home prices and ownership costs, as well as the highest interest rates in history. Additionally, this same period was marked by unprecedented rates of high unemployment.

Veterans, like all Americans, were adversely impacted by these economic conditions. As a result, there was a dramatic decline in the number of home loans guaranteed by the VA (Fiscal Year 1982 was the lowest since 1944), accompanied by an equally heavy increase in home loan defaults and subsequent foreclosures.

Fortunately those economic conditions have abated somewhat -- mortgage funds are generally more available, interest rates are down from their record breaking high in Fiscal Year 1982 and home prices have remained relatively stable. Additionally, the high rates of unemployment have also been reduced substantially.

Unfortunately, however, the VA Home Loan Guaranty Program continues to experience an unusually large number of foreclosures that have adversely impacted on the Loan Guaranty Revolving Fund. And, due to the continued large numbers of foreclosures last year Congress found it necessary to approve supplemental appropriations in order to replenish the depleted Loan Guaranty Revolving Fund.

Also, the Congress further addressed the dilemma of the VA's Loan Guaranty Revolving Fund by enacting legislation -- Public Law 98-369, the Deficit Reduction Act of 1984 -- that increased the user's fee from .5% to 1.0%, required the fee to be deposited in the Loan Guaranty Revolving Fund and extended authority to collect the fee through September 30, 1987. These provisions, together with others contained in Public Law 98-369 pertaining to the acquisition of properties and vendee loans (all of which became effective over the past eight months) were intended to directly assist the Loan Guaranty Revolving Fund.

And, as you know, Mr. Chairman, the Administration's Fiscal Year 1986 budget request proposes legislation to remedy the so-called ills of the Loan Guaranty Revolving Fund by (1) increasing from 1% to 5% the loan origination fee on all guaranteed and vendee loans; (2) allow for borrower/lender negotiated rates on guaranteed and vendee loans by terminating the Administrator's authority to set interest rates; and (3) repeal transfer authority from the Direct Loan Revolving Fund to the Loan Guaranty Revolving Fund.

Mr. Chairman, the DAV believes a number of administrative initiatives could be implemented to effectively deal with correcting the deficiencies of the Loan Guaranty Revolving Fund, as opposed to the Administration's proposed legislation that would, we believe, desiccate the VA Home Loan Program.

In this regard, we must ask a number of specific questions that have direct bearing on this issue.

1. What effort is the VA undertaking to ensure that veteran home buyers eligible for the VA Loan Guaranty meet reasonable credit standards prior to purchasing a home?
2. What steps has the VA taken to assist veterans who are in default and in danger of foreclosure?
3. We understand that it can take the VA and the Justice Department from six months to five years to finalize foreclosure actions. What actions are both agencies taking to improve their timeliness of completing these foreclosures?
4. Following foreclosure action, how actively does the VA pursue collecting the debt that has resulted from the foreclosure?
5. What is the overall effect of the provisions of the Deficit Reduction Act of 1984 (P. L. 98-369) on the Loan Guaranty Revolving Fund?

Mr. Chairman, we believe the answers to these questions could very well lead to administrative improvements that could result in substantial savings for the Loan Guaranty Revolving Fund. This is especially true if collected debts were deposited in the Loan Guaranty Fund; foreclosure actions were completed in a timely manner; only credit worthy veterans were approved for loans and veterans in default were to receive greater assistance from the VA.

As you know, Mr. Chairman, the VA's Inspector General has been investigating a mobile home industry "kick back" scheme and an "equity skimming" scheme in southern California.

Both schemes are defrauding veterans and the Veterans Administration. We believe it is only appropriate to utilize the funds collected from those who have violated the law to help the Loan Guaranty Revolving Fund which has been directly impaired as a result of these schemes. Therefore, we strongly believe that any and all funds secured as a result of fines and settlement agreements stemming from fraud in the VA Housing Program should be deposited in the Loan Guaranty Revolving Fund.

In this regard, Mr. Chairman, we would strongly urge you and the Committee to take appropriate action to provide legal authority for the VA to deposit such funds in the Loan Guaranty Revolving Fund.

Furthermore, we believe a legislative remedy is necessary to identify and assist those veterans who have already lost their homes through foreclosure and were victims of these fraudulent schemes.

In closing, Mr. Chairman, we would like to reiterate that during the past 40 years, the VA Housing Program has not only expanded the tax base of nearly every community in our country, but has also played an integral role in the growth and expansion of the housing and financial industries in the United States. The DAV urges you to continue your strong leadership role to ensure that veterans will continue to have a VA Housing Program from which they will benefit. We do not believe credit worthy veterans should pay for their earned benefit home loan guaranty entitlement.

That completes my statement, Mr. Chairman. I again wish to thank you and the members of the Committee for allowing us this opportunity to express the DAV's views on this important subject.

Mr. **Principi**. I will just ask a very few questions. Then perhaps we can submit additional questions for the record.

Mr. Egan, I was interested in learning from you whether the lending industry responded to your proposals in which lenders could purchase increases in the guaranty in 5-percent increments, up to a maximum 60 percent of the loan amount, in exchange for each interest point below the VA established maximum rate?

Mr. **Egan**. As indicated to the committee by the mortgage bankers, we have been working with the bankers, as well as some of the other veterans' organizations. The mortgage bankers have submitted not just one of our several proposals, but the entire package, to the task force that they created at the request of the Veterans' Administration.

And it is my understanding, from a conversation this morning, that the task force had its first opportunity to review these proposals yesterday. It isn't clear yet when their findings on our proposals will be available.

Mr. **Principi**. Could you share those findings with the committee when they are in?

Mr. **Egan**. Certainly.

Mr. **Principi**. OK.

Notwithstanding this provision, does The American Legion support mortgage insurance on VA home loans for the first 5 or 10 years of the mortgage in order to reduce the liability of the VA?

Mr. **Egan**. Well, we haven't thought of it in the same terms—in the same fashion as the private sector might think of mortgage insurance.

What we had suggested is an alternative to user fees.

If OMB wants to say that there is some equity to be established by making the user fee for veterans 3.8 percent because the user fee for FHA is 3.8 percent, it must be properly understood that FHA buyers are purchasing mortgage insurance, while the imposition of a user fee on veteran buyers requires the veteran to purchase nothing.

So, what we are saying is that if we can make the mortgage more secure by adding some mortgage insurance, if we're going to require the payment by the veteran of something up front, then the veteran ought to be purchasing something, rather than giving something away for nothing in return.

Mr. **Steinberg**. I have no questions, but I'd just like to thank you very much for your endurance in bearing with us for this whole hearing and also to excuse my temporary absence during the testimony.

I wanted to hear—I think this is kind of a fitting closing—Senator Cranston deliver his very eloquent remarks on the Social Security COLA issue, which is, I think, shortly to be voted on by the Senate. And I thought I would share, with those few that remain, this small anecdote.

At the very close of his remarks, Mrs. Hawkins, who is the proponent of the amendment that Senator Dole has placed before the Senate, asked the Senator from California, if, in view of his remarks, he would like to cosponsor her amendment.

And he paused and said, "Well, I guess not. But I will vote for it."

And so begins a long process before the Senate that will be with us, I think, for a long time.

Mr. PRINCIPI. If we could recess for a moment, I will try to ascertain whether the chairman is planning to return shortly. He may have additional questions. If we could just be on hold for a few minutes longer, and then we will adjourn.

Thank you.

[Recess.]

Mr. PRINCIPI [resuming]. The chairman is still tied up on the floor, so we will recess and hear the other witnesses and the witnesses for the closed session at a later date.

[Whereupon, at 1:25 p.m., the committee adjourned, subject to the call of the Chair.]

[The committee received the following prepared statements for the hearing record:]

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PREPARED STATEMENT OF BOB MORAN, ASSOCIATE LEGISLATIVE DIRECTOR, PARALYZED VETERANS OF AMERICA

Mr. Chairman and Members of the Committee, it is a privilege for me to appear here today and present the views and concerns of Paralyzed Veterans of America on the Home Loan Guaranty program administered by the Veterans Administration. I am Bob Moran, Associate Legislative Director of PVA.

Initially, I want to extend PVA's appreciation to you Mr. Chairman and Members of the Committee, for your ongoing efforts to improve the effectiveness of programs administered by the Veterans Administration that affect some 28 million veterans and their 54 million dependents.

PVA is appreciative for the opportunity to testify and work with you and your most competent and professional staff in this important endeavor.

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VETERANS ADMINISTRATION

HOME LOAN GUARANTY PROGRAM

Since the program's inception on June 22, 1944, the Veterans Administration's Home Loan Guaranty program has assisted approximately 11.5 million veterans and their families in obtaining suitable, affordable housing. Currently, Vietnam Era veterans receive half of the VA's guaranteed home loans, receiving in just three years over $14 billion in home loans.

The VA Home Loan Guaranty program is an entitlement program, with every veteran meeting the requirements, as provided by statute, being eligible for the guaranty of their mortgage up to 60 percent of the loan or $27,500, whichever is less.

In the event of default, the VA will pay to the lender the outstanding balance due on the loan plus costs incurred through foreclosure, up to the amount of the guaranty. In most cases, arrangements have been made for the lender to convey the property to the VA in order to encourage lender participation in the VA Home Loan Guaranty program and to minimize administrative costs. More importantly, the VA retains the flexibility to allow a deserving veteran to stay in the family home even after mortgage default.

This year, the Administration proposed increasing the "users fee" on VA guaranteed loans from one percent to five percent, and now the Administration and the Senate leadership have presented a revised position on increasing the origination (user's) fee to 3.8 percent, phased in over a four year period.

Listed below is the current position on the revised VA Home Loan Origination fee "phase-in" increase, 2.8 percent above the current 1 percent level:

1986- 2 percent
1987- 2.5 percent
1988- 3 percent
1989- 3.5 percent
1990- 3.8 percent

Veterans who use their VA guaranty entitlement, starting in 1986, would either have to pay the two percent origination fee up front, or have the user's fee added into the loan, which would thereby raise the amount of the mortgage to exceed the actual value of the property.

Today, the average loan amount of a VA guaranteed home is $65,900. By adding the new funding fee, veterans who pay the origination fee up front would be required, in 1986, to have at least a minimum of $1,300 cash, which would increase by the year 1990 to approximately $3,000--just to be eligible to use their VA housing guarantee.

Putting these added costs into the VA Home Loan Guaranty program would all but insure the demise of the program and of veterans being able to use their VA entitlement in obtaining affordable housing.

One of the most valuable benefits of the VA Home Loan Guaranty program has been the feature of no money down. A veteran may now buy a home with no down payment, providing his or her income is sufficient to support payments; the VA's home loan program is the only home lending program that carries this feature.

Another part of the housing proposal is to repeal the current authority to establish maximum interest rates and to allow for borrower/lender negotiated rates. Currently, under Title 38, the Administrator has the authority to set minimum allowable interest rates. In 1983, the Federal Housing Administration (FHA) policy, which was similar to the VA's current policy of a set interest rate, was repealed to allow for a negotiable rate.

The efficacy of this change certainly is questionable as illustrated by introduction of H.R. 1, legislation which would repeal the negotiable rate used by FHA, and revert it back to the policy as presently used by the VA. This alone should be an indication that the proposed method of negotiable rates by borrower/lender does not work.

PVA opposes the proposal of raising the user fee above the current level of one percent and to repeal the authority for setting the interest rates. We believe that the current VA Home Loan Guaranty program has and continues to serve veterans well, giving the veteran borrower the opportunity to secure a low cost loan, with no down payment, thereby fulfilling the American dream of owning a home.

Conclusion

Mr. Chairman and Members of the Committee, on behalf of the members of Paralyzed Veterans of America, I appreciate the time and attention given to our statement by this Committee.

PVA opposes the proposals which would increase the "users fee" for a VA Guaranteed Home Loan and to repeal the VA's authority in establishing the home loan interest rate. We believe that since its inception, over forty years ago, that the VA's Home Loan Guarantee program has and continues to serve its intended purpose -- providing veterans and their families with affordable housing.

This concludes my statement Mr. Chairman, and I will be glad to answer any questions that I can.

PREPARED STATEMENT OF DENNIS K. RHOADES, EXECUTIVE DIRECTOR, VIETNAM VETERANS OF AMERICA

Mr. Chairman, Vietnam Veterans of America (VVA) appreciates the opportunity to present our views here today to you and your colleagues on the Committee on Veterans' Affairs.

In light of your background, Mr. Chairman, as a banker in your home state, we hope that our suggestions will prove useful as the Committee moves to strengthen the structure of the Veterans' Administration Home Loan Mortgage Guaranty Program. Frankly, Mr. Chairman, Vietnam Veterans of America believes that preserving this program is neither the intent nor the effect of the proposals put forth by the Administration via the Office of Management and Budget. In our view, the primary purpose of the program is to ensure that veterans of modest means are enabled to become first time home owners. The Home Loan program is, in fact a vital veterans' readjustment program and the Administration's proposals should be viewed in that context. VVA believes it is time to eschew short term solutions that only play into the hands of those who want the Government out of the credit business. OMB's proposals have, in fact, ensured a major crisis every year to the solvency of the Loan Guaranty Revolving Fund (LGRF). We strongly urge this Committee and the Congress to restore authority to the VA to have full power to manage its loan portfolio, including the ability to make direct loans and to transfer funds from the Direct Loan Revolving Fund (DLRF) to the LGRF as needed. Restoration of this vital element of the program will insure that there will not be another crisis in Fiscal Year 1987. While this would neccesitate an appropriation of $400 million for FY '86, it makes much more sense than to continue to hike taxes on veterans by means of so-called "user fee."

Mr. Chairman, Vietnam Veterans of America urges you to reconsider the plan to hike the "user fee" to 3.8% over a period of five years. The Congressional Budget Office study of the President's original proposal found that merely "throwing numbers up" at the problem would only compound our difficulties. Vietnam Veterans of America believes that OMB's conclusions would hold just as true for a graduated tax hike to 3.8% as it would for a precipitous tax hike to 5%.

Mr. Chairman, VVA has invested much time and research into this program. Restoring the VA Home Loan Guaranty Program to full viability is one of VVA's key legislative priorities, as approved and directed by our National Board of Directors. VVA has had protracted and serious discussions with representatives of the lending industry and other veterans' service organizations seeking long term solutions, rather than short sighted "quick fixes" that will only compound the problem. VVA particularly appreciates the leadership, and thoughtfulness of The American Legion and the Mortgage Bankers Association of America in this regard.

Vietnam Veterans of America recommends six basic changes Mr. Chairman, that taken together, would restore the VA Home Loan Guaranty Program to solvency and fulfill the intent of the Congress which was expressed first in 1944, and has been reaffirmed many times since.

First, Vietnam Veterans of America would recommend that "Section F" of the VA Lenders Handbook be codified by means of the public rule making process, so that these guidelines will in fact become binding on all parties concerned. This is particularly important in regard to forebearence. In fact, some of the provisions in Section F need to be strengthened, primarily in regard to comsumer protection.

Secondly, as noted above, Vietnam Veterans of America would recommend that full authority and discretion for the VA to manage the direct and guaranteed loan portfolios be restored as soon as possible. This must be done by statute, to insulate VA as much as possible from the adverse and counterproductive meddling of those at OMB who wish the program to fail.

Third, the Veterans Administration must do a much better job of informing the individual veteran of his or her rights and responsibilities as a borrower under this program. This would include many common sense elements, such as better brochures and posters, in addition to increased cooperation with veterans' service organizations. The VA should also train counselors in every VA Regional Office to assist veterans who are in danger of default. At the time he or she receives the loan, the veteran should be advised that this counseling is available, and that the counselor can provide assistance as an advocate before an arrears situation deteriorates beyond redemption. Mr. Chairman, the economic turmoil of the last few years has been one of the principal reasons for the rising default rate. There is no reason why the VA home loan program should operate in a vacuum when the agency has the resources to provide services such as counseling and placement to a veteran in financial trouble.

Fourth, VVA would recommend that the VA be enabled, in fact as well as in statute, to participate in recasting loans to prevent foreclosure. This is presently being done in a few cases, but needs expansion. In this type of refinancing, the VA plays essentially the role of referee wherein the needs of the lender and the veteran would both be met. It is in every party's interest to keep the veteran in possession of his or her home. In many situations, personnel should be brought into the case as a formal condition of the loan.

Fifth, VVA believes there are other steps which may be taken to ease the immediate pressure to move toward foreclosure. A short term mortgage assistance insurance program, administered by the VA, would be ideal in this regard.

Sixth, Vietnam Veterans of America has for years extolled the virtues of the State of California's "CAL-VET" program. The CAL-VET program enables veterans to purchase single family homes at an affordable rate of 8% on a fixed term thirty year mortgage. The proposal that a similar program be enacted on a national scale has great merit, and Vietnam Veterans of America would favor its consideration with the Servicemans' Life Insurance pool considered as a possible funding source.

Vietnam Veterans of America would be pleased to have the opportunity to work with members of the Committee and your staff on the merits and the development of any of these recommendations, Mr. Chairman.

In summary, Mr. Chairman, Vietnam Veterans of America urges the Committee to put forth a comprehensive program that will preserve the long range viability of the VA Home Loan Mortgage Guaranty Program. As I have stated before, the key intent of this program for the last forty years, has been to enable veterans to become homeowners for the first time, and to fully readjust as productive members of American society. Given that the country is making note of the tenth anniversary of the Vietnam war, I might observe noting that only now are many Vietnam veterans, especially those who saw heavy combat, moving into the mainstream of American life. To impose a tax not imposed on any other generation of veterans is simply unfair. We urge your and this Committee to act to preserve the VA Home Loan Guaranty program, in its original effect, as a vital element in this larger effort to heal a nation and truly bring all of our soldiers home.

Mr. Chairman, VVA thanks the Committee for the opportunity to present our views here today.

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